

**MONITORING COUNTRY PROGRESS
IN CENTRAL AND EASTERN EUROPE &
THE NEW INDEPENDENT STATES**

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EXECUTIVE SUMMARY

I. Introduction and Methodology

This paper presents USAID/ENI's system for monitoring country progress with a focus on developing criteria towards graduation from USAID assistance. Country progress is analyzed in a sequence of steps for twenty-six countries of the region. First, we look at the progress towards economic reforms and democratization. Progress on both fronts must reach a certain threshold before we can begin to consider graduation.

Next, we look at indications of sustainability; that is, macroeconomic performance and social conditions. Economic reforms need to translate into solid macroeconomic performance if they are to be sustained. Trends in social conditions need to be tracked as well to give us a pulse on the possibilities of economic and democratic "reform fatigue." Social conditions influence macroeconomic performance, too.

The indicators are drawn from standard, well-established data sources that are external to USAID. An important step of the process is the holding of annual reviews—one for CEE, one for the NIS—with area specialists from U.S. government agencies.

II. Analysis

The *Summary Table* and *Summary Figure* (below) suggest three country groups differentiated by progress towards ***economic and democratic reforms***. At either end of the reform spectrum are two fairly well defined groups. The Northern Tier CEE countries (less Slovakia) are well out front, particularly in democratic reforms. Hungary is on top. The least advanced group is a small one that includes three Central Asian Republics (Turkmenistan, Tajikistan, and Uzbekistan), Belarus, and Bosnia-Herzegovina.

The middle group is the largest and the least well defined (or, the most diverse in terms of reform progress). This group includes the Southern Tier CEE countries (less Bosnia-Herzegovina), Russia, Ukraine and other NIS countries. Slovakia and Azerbaijan remain largely outside of the three country clusters. However, Slovakia progressed significantly in democratic reforms in 1998, and moved closer to the Northern Tier leaders in at least that regard.

The *Summary Table* shows that while the average ratings for economic policy reforms and democratic freedoms are the same for the transition region as a whole (that is, "2.7" out of a possible "5" for each), the variation in progress is significantly greater in the case of democratic reforms. The reform leaders have democratic freedoms roughly on a par with some Western democracies, while the democratic laggard, Turkmenistan, scores among the least democratic countries worldwide. In economic policy reforms, however, even the Northern Tier CEE countries still have far to go to reach the standards in the industrial market economies. This is particularly evident in the second stage economic reforms.

There appears to be a close correspondence between progress in economic and democratic reforms. Croatia and Ukraine may be the most apparent exceptions. Croatia is relatively further ahead in economic reforms; in Ukraine, it's the reverse.

Evidence provided in *Monitoring Country Progress* (October 1998) revealed the emergence of a growing economic and democratic reform gap between the transition leaders and laggards. The latest data show that this trend continues. Its onset is attributed in part to the emergence of the global financial crisis and economic slowdown.

In general, policy stagnation and/or backsliding have been more prevalent since mid-1997, and largely among the intermediate or least advanced reformers. In economic reforms, most of this has been backsliding in the first stage reforms. Sustaining the gains in liberalization and stabilization in the current global context have proved to be difficult without adequate progress in institutional and structural (second stage) reforms. Russia has stumbled the most. But reforms in Ukraine, Belarus, Turkmenistan, and Uzbekistan have been on hold at best on balance as well.

In contrast, many of the reform leaders have moved forward on second stage economic reforms, despite (or perhaps because of) the global market constraints. The most notable examples are Hungary and Poland. Recently, however, progress has also been evident in the Baltic States, particularly in Lithuania.

Democratic freedoms in 1998 decreased in five NIS countries (Kyrgyzstan, Azerbaijan, Kazakhstan, Russia, and Tajikistan) and increased in only two (Moldova and Armenia). Two Northern Tier CEE countries experienced some measurable increase in democratization (Slovakia and Latvia). None witnessed deterioration. The Southern Tier CEE countries experienced more backsliding in democratization (in Yugoslavia, Albania, and Croatia) than progress (in Macedonia).

As with progress in reforms, *macroeconomic performances* in 1998 and 1999 have been significantly influenced by external conditions. In fact, early estimates of the macroeconomic impact on the region from the global financial crisis largely underestimated the repercussions, particularly among the NIS countries. Most of the NIS countries have incurred high costs from the crisis due largely to sharply falling prices of commodity exports and/or close economic ties to a contracting Russian economy. These trends are continuing, and, in fact, economic contraction in the NIS in 1999 (at close to three percent) will likely be greater than that experienced in 1998 (close to two percent).

Growing inflation rates in the NIS have largely been tied to currency devaluations that in turn have been linked to economic turmoil in Russia. After falling significantly from triple-digit levels in the early to mid-1990s to nineteen percent in 1997, inflation has increased in the NIS to almost sixty percent in 1998. It is forecast to be higher in 1999 (sixty-four percent). Macroeconomic imbalances in the NIS remain too high. Nine NIS countries had 1998 current account deficits greater than five percent of GDP. Many saw deterioration due to the collapse of exports to Russia. All but Belarus and Ukraine had 1998 fiscal deficits in excess of three percent of GDP. More than one-half of the countries experienced

deterioration in the fiscal balance since 1997. The NIS external debt as a percent of exports (at 161 percent on average) continues to grow and is now comparable to the average for the developing countries. Debt service, however, remains low.

Among the Northern Tier CEE countries, economic growth has slowed from 5.7 percent in 1997 to 3.7 percent in 1998, and may be only 2.5 percent in 1999. The Baltic States experienced slower economic growth in 1998 due to close ties to Russia. Moreover, all the countries of the Northern Tier are witnessing slower growth in 1999 as economic growth in Western Europe slows, and with it, demand for Northern Tier CEE exports. The decline in inflation in the Northern Tier has been steady and impressive, and is now close to an annual rate of only eight percent. Labor productivity growth in industry has also been impressive.

However, current account balances have worsened significantly in the Northern Tier CEE countries on average, from a deficit of one percent of GDP in 1994-1996 to over five percent in 1998. These deficits are less burdensome if, as is the case in many Northern Tier CEE countries, they can be financed in large part by significant foreign direct investment inflows, and if they are used to purchase capital goods imports. Fiscal deficits increased some on average as well (to 3.3 percent of GDP in 1998). Macroeconomic imbalances are particularly high in Lithuania and Slovakia.

For the Southern Tier CEE as a whole, strong economic growth in 1994-1996 has given way to economic contraction in 1997-1999. This turn around is largely due to economic and political troubles in Romania, and more recently, the Kosovo crisis. Still, the subregional economic growth average masks wide diversity. Inflation fell significantly in Bulgaria, Albania, and Romania in 1998 after sharp increases in all three countries in 1997. It is still too high in Romania (at forty percent), and likely to remain so in 1999. Inflation rates in 1998 were equal to or less than ten percent for all CEE countries except Romania. 1998 fiscal deficits were too high in Romania (5.5 percent of GDP) and Albania (10.7 percent of GDP). Labor productivity lags behind Northern Tier standards, except perhaps in Croatia. Current account deficits continue to be too high throughout the Southern Tier, averaging eight percent of GDP in 1998.

The macroeconomic costs to the Southern Tier from the Kosovo conflict in 1999 look to be significant. Hardest hit in terms of economic growth will likely be Macedonia, followed by Bulgaria, Croatia, and Bosnia-Herzegovina. Of these countries, perhaps only the economy of Bosnia-Herzegovina will grow in 1999. Current account and fiscal deficits will worsen as well in most of the Southern Tier countries as a result of the conflict (though in the case of fiscal deficits, perhaps not as much as initially estimated given the extraordinarily quick return of the refugees). Albania and Macedonia are particularly vulnerable to growing macro-imbalances due to the conflict; Bulgaria and Croatia are to a lesser extent.

Social conditions continue to vary widely among the subregions. Unemployment continues to fall in the Northern Tier and increase in the NIS. It remains the highest (almost twelve percent in 1998) in the Southern Tier, and could rise further from the disruptions from Kosovo. Average income is back to pre-transition levels in the Northern Tier countries on

average (and rising), but closer to one-half the 1989 income levels in the NIS (and falling). The Southern Tier average is in between: 1998 GDP is seventy-four percent of 1989 GDP. Most recent data (1995-1996) show income inequality in most of the CEE countries to be much greater than pre-transition estimates, but comparable to Western Europe. Income inequality is highest in the countries of the former Soviet Union (i.e., the NIS plus the Baltic States). The trends in poverty are similar; lowest in the Northern Tier (roughly ten percent in 1993-1995); highest in the NIS (fifty percent); and somewhere in the middle in the Southern Tier (twenty-four percent).

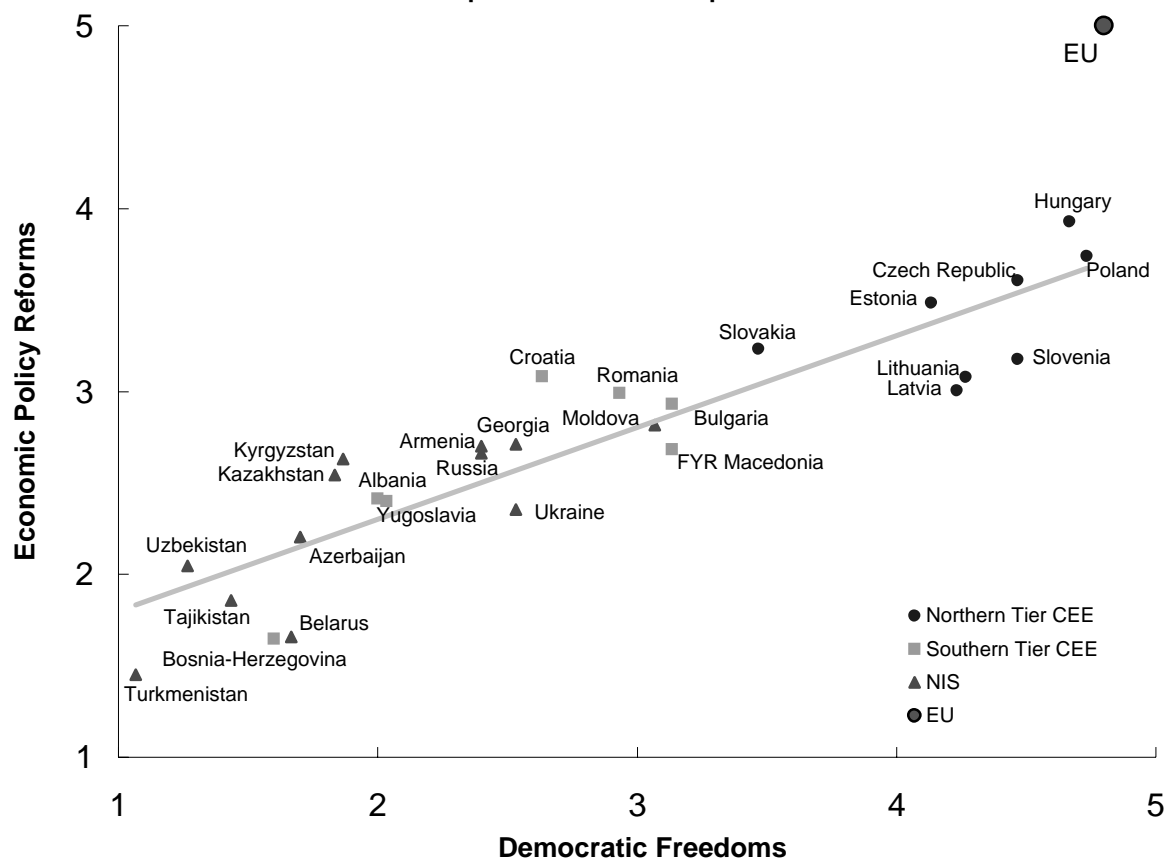
Infant mortality rates have fallen the most in the Northern Tier CEE countries since 1989, and are now (at nine deaths per 1,000 live births) comparable to OECD rates, but still above EU rates (of five deaths). The Southern Tier and NIS infant mortality rates are twice the Northern Tier rates. Life expectancy has increased for both males and females in the Northern Tier from 1989-1997, and continues to fall for both males and females in the NIS. In the Southern Tier, it is mixed: a slight increase for females; a decrease among males from 1989-1997. Finally, secondary school enrollments are highest in the Northern Tier (ninety-seven percent) where they have been increasing. In contrast, enrollments have been decreasing in both the Southern Tier and the NIS countries, and are the lowest in the Southern Tier (seventy-two percent).

III. Concluding Remarks

Decisions on the magnitude and duration of U.S. assistance to the ENI region are made on the basis of several factors: (1) progress the country has made toward a sustainable transition to a market-based democracy; (2) strategic importance of the country to the United States; (3) importance of the recipient country to U.S. citizens; and (4) effectiveness of particular assistance activities.

This paper presents an approach to analyzing the first factor. Particular country levels will likely be shaped in part by whether a given country falls into one of three categories, based on the analysis of country performance indicators. Countries ranked near the top of the list are obvious candidates for earlier “graduation.” Countries near the bottom of the list would seem to fall into one of three contrasting categories: (1) those where assistance is least likely to be effective, in which case it may make sense to close those programs down altogether or to keep highly targeted funding at minimal levels until their commitment to reform increases; (2) those where reform now appears likely but requires greater resources; or (3) those which possess characteristics that match well with the Agency's priorities for sustainable development programs. Countries in the middle of the list are likely candidates for continuing programs through existing funding mechanisms, as long as the assistance is effective and Congress continues to appropriate funds for this purpose.

Summary Figure. Economic Policy Reforms and Democratic Freedoms in Central & Eastern Europe and the New Independent States: 1998



Ratings of democratic freedoms are from Freedom House, *Nations in Transit 1998* (October 1998) and Freedom House, *Freedom in the World 1998-1999* (June 1999), and assess reforms through December 1998. With 1 exception, economic policy reform ratings are from EBRD, *Transition Report 1998* (November 1998), and cover events through early September 1998; economic policy reform rating for Yugoslavia is from Freedom House (October 1998). Ratings are based on a 1 to 5 scale, with 5 representing most advanced.

Summary Table. Economic Policy Reforms and Democratic Freedoms in Central & Eastern Europe and the New Independent States: 1998

Economic Policy			Democratic Freedoms		
Country	Rating (1 to 5)	Ranking	Country	Rating (1 to 5)	Ranking
Hungary	3.9	1	Hungary	4.7	1
Poland	3.7	2	Poland	4.7	1
Czech Republic	3.6	3	Czech Republic	4.5	3
Estonia	3.5	4	Slovenia	4.5	3
Slovakia	3.2	5	Lithuania	4.3	5
Slovenia	3.2	5	Latvia	4.2	6
Croatia	3.1	7	Estonia	4.1	7
Lithuania	3.1	7	Slovakia	3.5	8
Latvia	3.0	9	Bulgaria	3.1	9
Romania	3.0	9	FYR Macedonia	3.1	9
Bulgaria	2.9	11	Moldova	3.1	9
Moldova	2.8	12	Romania	2.9	12
Georgia	2.7	13	Croatia	2.6	13
Armenia	2.7	13	Georgia	2.5	14
FYR Macedonia	2.7	13	Ukraine	2.5	14
Russia	2.7	13	Armenia	2.4	16
Kyrgyzstan	2.6	17	Russia	2.4	16
Kazakhstan	2.5	18	Yugoslavia	2.0	18
Albania	2.4	19	Albania	2.0	18
Yugoslavia	2.4	19	Kyrgyzstan	1.9	20
Ukraine	2.4	19	Kazakhstan	1.8	21
Azerbaijan	2.2	22	Azerbaijan	1.7	22
Uzbekistan	2.0	23	Belarus	1.7	22
Tajikistan	1.9	24	Bosnia-Herzegovina	1.6	24
Belarus	1.7	25	Tajikistan	1.4	25
Bosnia-Herzegovina	1.6	26	Uzbekistan	1.3	26
Turkmenistan	1.5	27	Turkmenistan	1.1	27
Rating (1 to 5)			Rating (1 to 5)		
CEE & NIS	2.7		2.7		
Northern Tier CEE	3.6		4.5		
Southern Tier CEE	2.8		2.8		
NIS	2.5		2.2		
European Union	5.0		4.8		
OECD	--		4.6		

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MONITORING COUNTRY PROGRESS

I. Introduction

The programs of U.S. assistance to Central and Eastern Europe (CEE) and to the New Independent States (NIS) of the former Soviet Union have been envisioned, since their inception, as short-term programs to jump start the countries of this strategically critical region on their way to political and economic transitions. The objective is to help move these countries far enough along the road to becoming market-based democracies that they can complete the journey themselves.

Recent trends, as underscored in particular by the significant setback in Russia's transition, are contributing to a reassessment of USAID/ENI's initial, perhaps overly optimistic program assumptions. These more sobering trends make it all the more essential to closely monitor both the impact of the U.S. assistance programs themselves to maximize their effectiveness (*program impact monitoring*), as well as the progress of the countries more generally to determine whether continued assistance is necessary or justified (*country progress monitoring*). Program impact monitoring is done through a system of setting results targets and annually monitoring progress toward them and through less frequent special field evaluations. This paper presents USAID/ENI's system for monitoring country progress in twenty-seven countries of the region.

Country progress monitoring is done in part to determine whether the assistance program can be terminated either because: (a) the country is well launched on its way to a successful transition and cessation of assistance will no longer jeopardize that transition (i.e., graduation); or (b) the country is making so little progress that significant resources will have little impact. Monitoring is done semi-annually and results are shared with the State Department Coordinators for U.S. Assistance to each of the two regions. The Coordinators are charged with, among other things, determining the magnitude and duration of these transition assistance programs.

Section II below highlights the methodology. This is followed in *Section III* by analyses in each of the major areas examined: (a) economic policy reforms; (b) democratization; (c) macroeconomic performance; and (d) social conditions. *Section IV* briefly concludes. *Appendix I* elaborates on the rating schemes of the economic policy reform and democratization indicators. *Appendix II* examines in more explicit detail the cross-border repercussions from the Russian (and global) financial crisis, as well as some very preliminary estimates of the economic effects from the Kosovo conflict.

II. Methodology

Market-oriented reforms and democratization are the two pillars of USAID's program in the transition countries.¹ The primary challenge of this analysis thus is essentially to assess the progress on both fronts, with a particular focus on the sustainability of reforms.

Country progress is hence analyzed in a sequence of steps drawing from standard, well-established data sources that are external to USAID. First, we look at the progress towards economic reforms and democratization. Progress on both fronts must reach a certain threshold before we can begin to consider graduation.

Economic policy reforms are assessed by drawing from EBRD's rating scheme of transition indicators, and supplemented by a similar scheme from Freedom House. Progress in democratic freedoms is determined from Freedom House's rating of civil liberties and political rights, and from an effort on its part to further disaggregate the measurement of such freedoms.

Next, we look at indications of sustainability. Economic reforms need to translate into solid macroeconomic performance. If the implementation of economic policies is determined to be sufficient in a particular country and yet the economy is performing poorly, then they are not there yet. We might expect improved performance to kick in with a lag. But evidence of good macroeconomic performance would give us more confidence that the reformed economy is self-sustaining.

Furthermore, it is important to underscore that acceptable progress in the reforms must precede good macroeconomic performance. A cross-country snapshot might show one economy outperforming another in part because painful reforms have been avoided in the former. Yet, this is hardly sustainable.

The macroeconomic performance indicators also provide a check on the comprehensiveness of the economic reform indicators. For example, fiscal reform is likely not adequately addressed in the current mix of economic reform indicators. Yet, insufficient fiscal reform is likely to surface in the form of bloated fiscal deficits, and this *is* being tracked as an economic performance indicator.

Another means to measure the sustainability of both economic and political reforms is to assess trends in social conditions. This is largely the concern of "reform fatigue." The population may not continue to support difficult reforms if the standard of living for many declines drastically. It may not be good enough, in other words, to have sound economic policies in place, solid macroeconomic performance, and extensive political

¹ USAID assistance to the transition countries is funded through the Support for East European Democracy Act (SEED) and the Freedom Support Act (FSA), the latter applying to the NIS countries. The SEED Act has two goals: the promotion of democracy and a market-oriented economy. The FSA objectives are broader in scope, including the transition goals of the SEED Act as well as those focused more directly on humanitarian, social, environmental, and trade and investment conditions.

and civil liberties, if a significant proportion of the population is losing out on balance. Fiscal sustainability hinges in part on social conditions and expenditures, too.

As the transition continues, the links between deteriorating social conditions and poor economic performance may need to be a greater concern as well. For example, the conventional wisdom, drawing primarily from the available (1993-1995) data, continues to hold that poverty is relatively shallow in the transition countries; most of the poor are not far below the poverty threshold. But where the poverty rate continues to increase, so may also the proportion of the population that sinks further into deeper-seated poverty and into an unproductive, underclass status.

Country progress is assessed throughout this report with population-weighted measures of progress of three subregions among the transition economies as well as with comparators outside the region. The Northern Tier Central and Eastern Europe consists of Poland, Hungary, Slovenia, the Czech Republic, Slovakia, Estonia, Latvia, and Lithuania; the Southern Tier CEE consists of Romania, Bulgaria, Croatia, the FYR Macedonia, Albania, Bosnia-Herzegovina, and, when data are available, Yugoslavia; and the New Independent States consist of the countries formed from the dissolution of Soviet Union less Latvia, Lithuania, and Estonia.

For most indicators, proposed graduation benchmarks are assigned. Some are more arbitrary than others and need to be held to debate. Should a country fail to meet a benchmark, this should signal a “yellow flag” in the mind of the analyst; an aspect that may need to be examined more thoroughly if graduation is being considered on the basis of other evidence. The number of benchmarks a country needs to achieve should vary according to context.

An important step of the process is the holding of annual reviews—one for CEE, one for the NIS—with area specialists from U.S. government agencies. Soliciting such expert opinion serves as a reality check on the data and our interpretation of it.

Finally, it merits explicitly recognizing that what is occurring in the region is unprecedented, and that there is little if any theoretical and/or empirical basis for devising precise thresholds of reform sustainability. Further, it is reasonable to assume that there is more than one acceptable transition route, or, what may amount to the same, many possible varieties of sustainable market-oriented democracies. This exercise, in short, is likely to be as much art as it is science, and it is important to place the results in this context.

III. Analysis

A. Economic Policy Reforms

Progress towards economic policy reforms is primarily assessed from indicators drawn from the EBRD's annual *Transition Report* (November 1998) and supplemented with analyses from the EBRD's *Transition Report Update* (April 1999). Sufficient progress must entail both an adequate threshold of reform as well as a favorable trend over time; that is, no significant policy backsliding.

Twelve economic policy reform indicators, grouped into two stages of reform, are tracked.² The indicators are measured on a one-to-five scale, with gradations in between.³ A "five" represents standards and performance norms typical of advanced industrial economies. In general, depending on the particular indicator, a "3" or a "4" may very well be the threshold that we seek. Descriptions of the rating categories are provided in *Appendix I*.

These indicators, in sum, focus on critical economic reform aspects of liberalization, structural reform, and institution building in the transition process. Such reforms provide much of the overall enabling environment that is required for the emergence of a vibrant and sustainable market economy. Moreover, strong complementarities exist among them all. This means that possibilities for synergism derive from implementation of the total policy package. The other side to this is the possibility that insufficient progress in one reform aspect may undermine the potential gains from progress of another. As is highlighted below, this latter possibility has recently become an important characteristic of the reform profile among some of the transition laggards.

First Stage Reforms (*Table 1*). The first stage reforms consist of liberalization of prices, external trade and currency arrangements, privatization of small-scale units, and the establishment of key commercial laws. **Price liberalization** focuses on the decontrolling of wages and product market prices, including key infrastructure products such as utilities and energy, and the phasing out of state procurement at non-market prices. **Trade and foreign exchange reforms** focus on the removal of trade restrictions (export tariffs, quantitative and administrative import and export restrictions), progress towards membership in the WTO, and improving access to foreign exchange (current and capital account convertibility). **Small-scale privatization** includes small firms, small farms and plots of land, and housing. The **legal reforms for investment** focus on three laws: bankruptcy, pledge or collateral, and company law.

² Three changes have been made since the last *Monitoring Country Progress* (October 1998) in how we track economic policy reforms. First, the three reform "rounds" have been simplified into two. Second, we separated the EBRD's two legal reform components; the extensiveness of legal reforms is now part of the first stage economic reforms, and the effectiveness of such reforms is part of the second stage. Finally, partly in response to a suggestion, which emerged from the November 1998 inter-agency review, we've incorporated the EBRD's measure of restructuring infrastructure as a component of second stage reforms.

³ In earlier *Transition Reports*, the EBRD assigned a 4* to the highest threshold and provided a separate description of the criteria to achieve that level of progress. For simplicity, their "4*" (which is now a 4+) becomes our "5". All other "+"s and "-"s are measured by adding or subtracting a "0.3", respectively.

Alongside the growth of new firms, privatization is an essential aspect towards restructuring the economy into one that is private-sector driven. Price liberalization provides the appropriate incentives through market-based prices to better maximize efficiency. Trade and foreign exchange reforms provide further discipline for the private sector through global competition, as well as providing domestic firms with a greater capacity to compete. Consistent, nondiscriminatory, and transparent legal rules for investment are critical towards developing an enabling environment for enterprise restructuring and growth, and improved corporate governance.

These first stage reforms require relatively little institution building and tend to be the easiest to do. However, as underscored by recent trends in the NIS, progress in these reform areas can also be prone to setbacks. These dynamics, in fact, help explain why the spread between economic reform progress among the transition leaders and laggards is greatest in trade and foreign exchange reforms.

In the CEE countries, the first stage reforms have generally been adopted rapidly and quite thoroughly. All the CEE countries (for which data are available)⁴ have implemented a comprehensive program of price liberalization; other than rents, transport and public utilities, prices are generally set by the market. With the salient exception of Bosnia-Herzegovina (where privatization has largely not yet begun), most CEE countries have essentially completed small-scale privatization.

In addition, virtually all quantitative and administrative trade restrictions (apart from agriculture) have been removed in all the CEE countries but Bosnia-Herzegovina. Eight CEE countries now are members of the World Trade Organization; Latvia became the first Baltic State to join, in February 1999. Moreover, four Northern Tier countries (Hungary, Poland, Slovakia, and Slovenia) have achieved policy standards towards small-scale private enterprise and in trade and foreign exchange systems that are comparable to those of the advanced industrial economies.

Advancements in legal reforms in CEE lag some behind the other first stage reforms. For only one-half of the CEE countries, comprehensive legislation exists in at least two of the three areas of commercial law that have been the focus of the EBRD survey: pledge; bankruptcy; and company law. Albania and Bosnia-Herzegovina are the furthest behind in legal reforms; there the legal rules are limited in scope and subject to conflicting interpretations.

The prospects of memberships into Western institutions continue to provide strong incentives to reform in the CEE. In this vein, the European Commission's interim report in November 1998 of progress towards accession to the EU for the five invited Northern Tier members provided a positive assessment of progress in Estonia, Hungary, and Poland. The Czech Republic and Slovenia received a less favorable assessment due to slower progress in adapting legislation to the EU *acquis communautaire*. However, Slovenia has since moved forward on reducing some capital account restrictions.

⁴ Yugoslavia is not included in EBRD's rating scheme.

In general, progress in the first stage reforms in the NIS countries lags considerably behind CEE gains. Moreover, this reform gap continues to grow in large part because of recent backtracking in several NIS countries. Some of this, such as the increase in price controls in Belarus and Uzbekistan in early 1998, preceded the August 1998 Russian financial crisis. Much of it, however, is partly an outcome of the Russian crisis and its spillover to the region. This includes the introduction of new capital and exchange controls in August and September 1998 in Russia and Ukraine, the re-introduction of price controls in parts of Russia, the re-emergence in Turkmenistan of a substantial black market premium, and, more recently, the imposition in March 1999 of trade restrictions in Kazakhstan.

Some of these restrictions have since been at least partially lifted. Most notable perhaps have been the policy shifts in Kazakhstan. On April 2, 1999, Kazakhstan's currency was devalued, and the government announced the elimination of the protectionist policies that had been introduced largely to support the overvalued currency.

Of the NIS countries, Moldova has advanced the furthest in first stage reforms, followed closely by Kyrgyzstan, Georgia, and Armenia. Moldova's progress in these reforms is roughly comparable to that of Latvia's. First stage reforms in Kyrgyzstan, Georgia, and Armenia are roughly on a par with those of Bulgaria and Macedonia. For these NIS leaders, privatization of small companies with tradable ownership rights is complete or close to completion. Substantial progress on price liberalization including for energy prices has been made. Virtually all quantitative and administrative trade restrictions have been removed. New or amended legislation has been enacted in key commercial areas of commercial law in the case of Georgia and Kyrgyzstan; for Moldova and Armenia, comprehensive commercial law legislation exists.

Turkmenistan and Belarus lag behind all other transition countries in first stage reforms, and far behind most. In both, government control of prices is extensive. Trade and foreign exchange restrictions are significant. Legal rules are limited in scope and inconsistent. Overall commitment to reform continues to be very weak.

Tajikistan is distinguished by having made notable broad-based progress since early 1998 in the first round reforms and beyond. This includes progress in liberalization (both of domestic prices and in trade and foreign exchange) and in small-scale privatization. Of the NIS leaders, Moldova and Kyrgyzstan in particular, continue to move forward in first stage reforms. In late 1998, Kyrgyzstan became the first NIS country to join the World Trade Organization.

Finally, one of the lessons, drawing from recent trends, would seem to be that early gains in liberalization and stabilization may be difficult to sustain in the absence of supporting institutional and structural reforms (i.e., in the absence of implementing the second stage reforms). Similarly, the slower reformers are likely more susceptible and vulnerable to backsliding in the current global context. Still, this is not to say that the transition leaders are immune to setbacks along the way. For example, a handful of countries, including

Slovakia, Slovenia, the Czech Republic, and Macedonia, resorted to temporary wage controls in 1997 in the face of fiscal pressures. Croatia tightened capital controls in the spring of 1998 to stem an excessive inflow of foreign capital, which in turn was fueling excessive domestic credit growth. The Czech Republic and Slovakia both implemented import surcharges in 1997 to ward against growing current account deficits and to maintain the value of the domestic currencies.

Second Stage Reforms (Table 2). Most of the economic reforms and the most challenging economic reforms are included in the second stage. By and large, these are changes that are characterized by fundamental economic restructuring and/or by institution building. Not surprisingly, progress in these reforms has been slower than that of the first stage reforms for a handful of inter-related reasons. They require a greater technical capacity on the part of government. They require more preparation to build political consensus; they typically generate greater political resistance and uncover stronger vested interests. Similarly, building institutions and effective regulatory entities by nature is an incremental, long-term process. An important part of this is bringing behavior consistent with market-oriented democracies in line with the new physical institutions.

We draw from the EBRD to track eight specific reforms that we classify as part of the second stage. **Large-scale privatization** includes assessing the extent of the transfer of assets to the private sector, but also the extent of outside ownership and effective corporate governance of such entities. **Enterprise restructuring reforms** address effective corporate governance in large part through government actions to tighten credit and subsidy policy at the firm level, enforce bankruptcy legislation, and break up dominant firms. Such reforms, in other words, provide some of the financial discipline needed for vibrant growth of the private sector.

Closely related to these reforms is **competition policy** which focuses on the development of legislation and institutions to facilitate the entry of firms, existing or potential, into existing markets. This includes the promotion of a competitive environment through enforcement actions to reduce the abuse of market power by dominant (or non-competitive) firms. The more competitive is the market structure, the greater is the efficiency of the firm.

Banking reform includes progress towards the establishment of bank solvency, well-functioning bank competition coupled with interest rate liberalization, financial deepening and extensiveness of private sector lending, and effective prudential supervision, with movement of laws and regulations towards BIS standards. **Non-bank financial reforms** (or capital market reforms) include the development and deepening of securities exchanges, investment funds, private insurance and pensions funds, leasing companies, and associated regulatory framework, with movement of laws and regulations towards IOSCO standards.

The financial system undergirds the market economy. The private sector cannot grow and develop without a sound financial sector. It provides the capital to grow. It provides

the discipline towards good corporate governance. Nor can there exist a stable macroeconomic framework without a sound financial system, given its importance in overall monetary management. Moreover, an unstable financial sector can lead to crisis, and, in fact, most of the significant economic setbacks that have occurred in the transition economies have been largely triggered by financial crisis. Russia is the most recent example, though economic crises in Bulgaria and Albania in 1996-1997 and backsliding in the Czech Republic in 1997 apply as well.

The degree to which *investment-related legal reforms* are successfully *implemented* is a focus as well. This follows from tracking as part of the first stage reforms, the extensiveness of such reforms—in particular, bankruptcy, collateral, and company law. Here the focus is how clear these rules are (and the degree to which they do not discriminate between domestic and foreign investors), and how well they are administered and supported judicially.

Environmental policy reforms include four components: (a) the degree of adherence to six key international environmental treaties; (b) progress in air and water standards; (c) progress in preparing and implementing national environmental action plans; and (d) an assessment of the extent to which environmental financial incentive mechanisms are used. Progress in environmental reforms contributes directly to progress in other economic reform areas.

Finally, the *restructuring of infrastructure* includes the commercialization (including privatization) and regulation of the telecommunications, railways, and electric power industries. The physical infrastructure plays a central role in the productivity of an economy. In general, the transition countries face very significant infrastructure investment requirements (with very limited means to meet them) due to previous policies that grossly distorted incentives. During central planning, some environmental services, such as water and power, were oversupplied and at prices well below costs (both in an economic and environmental sense), while services such as telecommunications were largely undersupplied.

Judging by industrial market economy standards, all the transition countries still have far to go in progress in second stage economic reforms. There are four transition countries, however, that come closest to that standard and that are relatively far ahead of the rest. Hungary is the leader, followed by Poland, the Czech Republic, and Estonia.

In at least three of these countries (Poland is the possible exception), more than fifty percent of large-scale state-owned enterprise assets have been privatized in schemes that have generated substantial outsider ownership. In all four countries, there have been significant and sustained actions to harden budget constraints and to promote corporate governance effectively. On competition policy, there has been a substantial reduction of restrictions on firms to enter markets, and some enforcement actions to reduce abuse of market power. Substantial progress has been made in the establishment of bank solvency and of a framework for prudential bank supervision and regulation. In Hungary's case, progress in banking reforms has gone further and includes significant movement of banking laws and regulations towards BIS standards and substantial financial deepening.

In all four countries, commercial laws are reasonably clear and administrative and judicial support of the law is reasonably adequate.

In general, the rankings of progress in the second stage reforms roughly conform to the first stage reform rankings. The Northern Tier CEE countries are well out front, followed by progress in the Southern Tier CEE countries and then the NIS countries. Southern Tier CEE progress is closer to NIS standards than Northern Tier CEE norms. Second stage reform progress in Bosnia-Herzegovina lags far behind the CEE countries and in fact is comparable to that found in the NIS laggards. Albania, and to a lesser extent, Macedonia, also lag behind the CEE levels.

In the NIS, Moldova, Russia, Georgia, and Armenia are farthest along in second stage reforms, though behind all but three CEE countries. Among these NIS leaders, anywhere from more than twenty-five percent to fifty percent of large-scale state-owned enterprise assets have been privatized or are in the process of being sold, but often with major unresolved issues regarding corporate governance. On enterprise restructuring, there has been moderately tight credit and subsidy policy but weak enforcement of bankruptcy legislation and little action taken to break up dominant firms. Competition policy legislation and institutions have been set up, and there has been some reduction of entry restrictions or enforcement action on dominant firms. In bank reforms, significant liberalization of interest rates and credit allocation has taken place, but there has not yet been much progress in the establishment of bank solvency and of a framework for prudential supervision and regulation. In three of these four countries, commercial legal rules are reasonably clear, though administration and judicial support of the law is typically inadequate or inconsistent. In Russia, the commercial legal rules are generally unclear and contradictory, and there are few, if any meaningful procedures in place to make commercial laws operational and enforceable.

As with first stage reforms, Turkmenistan, Belarus, Tajikistan, and Uzbekistan have made the least progress in the NIS in second stage reforms. Azerbaijan is also in this group in the second stage reforms. Typically for these countries, a comprehensive scheme for large-scale privatization is not yet ready for implementation. Few if any reforms have been implemented to promote corporate governance; soft budget constraints prevail. In most of these countries, widespread market entry restrictions for firms exist, and competition legislation and institution do not exist. Very little progress in financial reforms (banks and non-banks) has been made. While Tajikistan may be slightly ahead towards establishing a viable commercial law framework, in general, there are few, if any meaningful procedures in place in order to make commercial laws operational and enforceable in these countries.

There has been a fairly wide variation among the transition countries in policy responses and progress in second stage reforms in the context of the global financial crisis and economic downturn. With exceptions, most of the recent gains in second stage reforms have occurred in the CEE countries and in the Northern Tier in particular. In general, progress in such reforms in the NIS has slowed, and many second stage reforms have been put on hold.

This trend holds, for example, in large-scale privatization. Overall, the relatively rapid pace of large-scale privatization in 1997 and early 1998 has slowed. Delays in some countries, such as in Russia and Kazakhstan, reflect a desire on the part of governments to wait until better conditions (for maximizing revenues) prevail. In the cases of other delays, such as with the Stopanska Banka in Macedonia, privatization has been put off due to a lack of foreign investor interest. In yet other cases, in Armenia and Ukraine, for example, political opposition has stifled privatization initiatives.

Yet, in other instances, most notably perhaps in the telecommunications sector in Poland and Estonia, governments have recently gone forward with major sales of state assets. Other privatizations in this sector look to be in the works and include efforts in Hungary, Croatia, Kazakhstan, as well as perhaps in Bulgaria and Albania.

Recent progress in banking reforms has diverged widely as well. Most notable is the continuation of lackluster progress in Russia's banking system. A state agency was recently set up to restructure the banks, but lacks the capacity (the financial means and the skills) to do so. In addition, the Central Bank has moved slowly to take administrative control of insolvent banks. As a consequence, extensive asset stripping by Russian bank managers and shareholders of their insolvent institutions continues. To contrast, at least a handful of governments in CEE, including those in Estonia, Croatia, Latvia, and Romania, have been much more effective recently in restructuring and/or liquidating weak or insolvent banks.

Of all the economic policy reforms, financial sector reforms (bank and non-banks), competition policy, and enterprise restructuring reforms tend to lag the most throughout CEE and the NIS. Good corporate governance remains a major challenge. In fact, the financial discipline of firms has deteriorated in a number of countries. Enterprise arrears in Russia are now estimated to be around forty-five percent of GDP. Barter between firms and often with government remains pervasive, and at least in Russia is on the rise. Moreover, the implementation of effective bankruptcy policies remains elusive for many governments. Finally, the failure to pay public utilities is a major source of soft budget constraints for loss-making enterprises. Failure to move forward on many of these reform aspects stems in part from the concern of adverse social consequences and political repercussions if firms are allowed to fail. Yet, the policy failure itself severely undermines the competitiveness of the private sector and its ability to productively engage and support the population.

Trends over Time in Economic Policy. *Tables 1 and 2* give us a snapshot of the cumulative progress in economic reforms through early September 1998. This was updated in the previous section by largely drawing from the EBRD's qualitative assessments from its *Transition Report Update* (April 1999). *Table 3* shows how this progress has changed over the medium-term: from 1994-1998. Which countries have made the most progress in this period? Which countries have made the least progress? Which reforms across the countries have advanced the furthest? Where has there been backsliding?

Overall, the greatest gains in economic policy reforms over this five year period have occurred among some of the “middle-tier” reformers; in particular, Georgia, Azerbaijan, Armenia, Kazakhstan, Ukraine, and Moldova. This reflects a combination of similar characteristics. First, these countries were essentially just beginning in 1994 to undertake the transition reforms. Progress tends to be most evident in the early years when the easiest (first stage) reforms are first undertaken. Second, all of these governments, at least at times, have had the political will and adequate capacity to move forward.

In general, progress has tended to be less evident over this medium term period among the transition reform leaders of the Northern Tier CEE because these countries, by and large, had already made the easy gains by 1994. By the mid-1990s, these countries had begun the slower process of focusing on the implementation of the more demanding second stage reforms. Of this group, the Czech Republic and Slovakia have shown the least progress on balance from 1994-1998. More recently, however, Slovakia looks to be poised to move forward once again.

By these measures, only one country, Belarus, was farther behind in economic reforms in the fall of 1998 than in 1994. Since late 1998, Belarus has likely backtracked on balance in first stage reforms and has made little progress in second stage reforms.

Partial or temporary setbacks in other countries, however, have not been uncommon. On the contrary, starts and stops and occasional backsliding have characterized most country transition paths. Moreover, policy stagnation and/or backsliding have been more prevalent since mid-1997 than in the previous four years.

This trend, of course, meshes with the onset of the global financial crisis and economic slowdown. Since this period, the economic reform gap between the Northern Tier CEE leaders and the rest has been growing.⁵ Broadly, many of the reform leaders have moved forward on second stage reforms, despite (or perhaps because of) the global market constraints. The most notable examples are Hungary and Poland. Recently, however, progress has also been evident in the Baltic States, particularly in Lithuania. Prospects for reform in Slovakia look promising as well, in light of the new reform-minded government.

In contrast, many of the reforms in the NIS have stalled, at least temporarily. Most of this has been backsliding in the first stage reforms. Russia has stumbled the most, both in liberalization reforms and in financial sector reforms. This deterioration stems primarily from the virtual breakdown of the banking system and the financial markets in Russia following the August 17, 1998 devaluation of the ruble, the forced restructuring of the government's short-term debt, and the moratorium on commercial debt payments. But

⁵ As implied above, prior to this period, in contrast, the economic reform gap had been closing between the middle-tier reformers, who had been making at least the most visible gains, and the leading reformers, who began increasingly to confront the more difficult second stage reforms.

reforms in Ukraine, Belarus, Turkmenistan, and Uzbekistan have been on hold on balance as well.

For the transition countries as a whole, since 1994, the reform area, which has witnessed the greatest progress, is in small-scale privatization. This is followed by the establishment of a commercial law framework. Progress in large-scale privatization is not far behind. In two areas, price liberalization and capital market reforms, backsliding has outweighed progress since 1994. This is primarily attributed to recent events in Russia.

Table 1. First Stage of Economic Policy Reforms

	Small Scale Privatization	Trade and Foreign Exchange	Price Liberalization	Legal Reforms (Extensiveness)	1st Stage Average
Hungary	5.0	5.0	3.3	4.0	4.3
Poland	5.0	5.0	3.3	4.0	4.3
Croatia	5.0	4.0	3.0	4.0	4.0
Czech Republic	5.0	4.0	3.0	4.0	4.0
Slovakia	5.0	5.0	3.0	3.0	4.0
Slovenia	5.0	5.0	3.0	3.0	4.0
Estonia	5.0	4.0	3.0	3.0	3.8
Lithuania	4.0	4.0	3.0	4.0	3.8
Latvia	4.0	4.0	3.0	3.3	3.6
Moldova	3.3	4.0	3.0	4.0	3.6
Romania	3.3	4.0	3.0	4.0	3.6
Armenia	3.0	4.0	3.0	4.0	3.5
Bulgaria	3.0	4.0	3.0	4.0	3.5
FYR Macedonia	4.0	4.0	3.0	3.0	3.5
Georgia	4.0	4.0	3.0	3.0	3.5
Kyrgyzstan	4.0	4.0	3.0	3.0	3.5
Kazakhstan	4.0	4.0	3.0	2.3	3.3
Albania	4.0	4.0	3.0	2.0	3.3
Russia	4.0	2.3	2.7	3.7	3.2
Azerbaijan	3.0	3.0	3.0	3.0	3.0
Ukraine	3.3	2.7	3.0	2.0	2.8
Tajikistan	2.3	2.7	3.0	2.0	2.5
Uzbekistan	3.0	1.7	2.0	2.3	2.3
Bosnia-Herzegovina	1.0	2.0	3.0	2.0	2.0
Belarus	2.0	1.0	2.0	2.0	1.8
Turkmenistan	2.0	1.0	2.0	...	1.7
CEE & NIS	3.8	3.1	2.8	3.3	3.2
Northern Tier CEE	4.9	4.8	3.2	3.9	4.2
Southern Tier CEE	3.3	3.9	3.0	3.7	3.5
NIS	3.6	2.5	2.7	3.1	3.0
Industrial Countries	5.0	5.0	5.0	5.0	5.0
Benchmarks	4.0	4.0	3.0	4.0	3.8

Note: On a 1 to 5 scale, with 5 being most advanced. All regional averages in this report are population-weighted.

EBRD, *Transition Report 1998* (November 1998).

Table 2. Second Stage of Economic Policy Reforms

	Large Scale Privatization	Enterprise Restruct.	Competition Policy	Banking Sector	Capital Markets	Legal Reform (effectiveness)	Environment Policy	Infra- structure	2nd Stage Average
Hungary	4.0	3.3	3.0	4.0	3.3	4.0	4.5	3.8	3.7
Poland	3.3	3.0	3.0	3.3	3.3	4.0	4.5	3.2	3.5
Czech Republic	4.0	3.0	3.0	3.0	3.0	4.0	4.5	2.8	3.4
Estonia	4.0	3.0	2.7	3.3	3.0	4.0	3.5	3.3	3.4
Slovakia	4.0	2.7	3.0	2.7	2.3	2.0	4.0	2.1	2.9
Slovenia	3.3	2.7	2.0	3.0	3.0	3.0	2.5	2.6	2.8
Lithuania	3.0	2.7	2.3	3.0	2.3	3.0	3.0	2.6	2.7
Latvia	3.0	2.7	2.7	2.7	2.3	2.0	3.5	2.9	2.7
Romania	2.7	2.0	2.0	2.3	2.0	4.0	3.5	3.1	2.7
Bulgaria	3.0	2.3	2.0	2.7	2.0	4.0	2.5	2.7	2.6
Croatia	3.0	2.7	2.0	2.7	2.3	3.0	3.0	2.3	2.6
Moldova	3.0	2.0	2.0	2.3	2.0	3.0	3.0	2.2	2.4
Russia	3.3	2.0	2.3	2.0	1.7	2.0	3.5	2.4	2.4
Georgia	3.3	2.0	2.0	2.3	1.0	3.0	2.5	2.4	2.3
Armenia	3.0	2.0	2.0	2.3	2.0	3.0	2.0	2.1	2.3
FYR Macedonia	3.0	2.0	1.0	3.0	1.0	4.0	2.0	2.2	2.3
Kyrgyzstan	3.0	2.0	2.0	2.7	2.0	2.0	2.0	1.9	2.2
Ukraine	2.3	2.0	2.0	2.0	2.0	2.0	3.0	2.0	2.2
Kazakhstan	3.0	2.0	2.0	2.3	2.0	2.0	1.5	2.4	2.2
Albania	2.0	2.0	2.0	2.0	1.7	2.0	2.5	1.8	2.0
Uzbekistan	2.7	2.0	2.0	1.7	2.0	2.0	1.5	1.7	1.9
Azerbaijan	2.0	2.0	1.0	2.0	1.7	2.0	2.0	1.8	1.8
Belarus	1.0	1.0	2.0	1.0	2.3	2.0	2.5	1.1	1.6
Tajikistan	2.0	1.7	1.0	1.0	1.0	3.0	1.5	1.1	1.5
Bosnia-Herzegovina	1.0	1.7	1.0	2.0	1.0	1.0	2.3	1.8	1.5
Turkmenistan	1.7	1.7	1.0	1.0	1.0	...	2.0	1.1	1.4
CEE & NIS	3.0	2.2	2.2	2.2	2.0	2.5	3.2	2.4	2.5
Northern Tier CEE	3.5	3.0	2.9	3.3	3.1	3.7	4.3	3.1	3.4
Southern Tier CEE	2.6	2.1	1.9	2.4	1.9	3.5	3.0	2.7	2.5
NIS	2.9	2.0	2.1	1.9	1.8	2.1	2.9	2.2	2.2
Industrial Countries	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Benchmarks	4.0	3.0	4.0	3.0	4.0	4.0	4.0	3.0	3.6

Note: On a 1 to 5 scale, with 5 being most advanced.

EBRD, *Transition Report 1998* (November 1998); environmental policy ratings are drawn from EBRD, *Transition Report 1997* (November 1997).

Table 3. Change in Economic Policy Reforms: 1994-1998

	1st Stage			2nd Stage					LR	Average
	SSP	PL	TFE	LSP	ER	CP	BR	CM		
Georgia	2.0	0.0	3.0	2.3	1.0	1.0	1.3	0.0	1.0 (+)	1.3
Azerbaijan	2.0	0.0	2.0 (+)	1.0	1.0	0.0	1.0	0.7 (+)	2.0 (+)	1.1
Armenia	0.0	0.0	2.0	2.0	1.0	1.0	1.3	1.0 (+)	1.0	1.0
Kazakhstan	2.0 (+)	0.0	2.0	1.0	1.0	0.0	1.3	0.0	0.0	0.8
Ukraine	1.3	0.0	1.7 (-)	1.0	1.0	0.0	1.0	0.0	1.0	0.8
Moldova	1.3 (+)	0.0	2.0	1.0	0.0	0.0	0.3 (+)	0.0	2.0 (+)	0.7
Latvia	1.0	0.0	0.0	1.0	1.0	0.7	-0.3 (-)	0.3	1.3 (-)	0.6
Bulgaria	1.0	0.0	0.0	1.0	0.3	0.0	0.7	0.0	2.0 (+)	0.6
Romania	0.3 (+)	0.0	0.0	1.0	0.0	1.0	0.6 (-)	0.0	2.0 (+)	0.6
Hungary	1.0	0.3	1.0	1.0	0.3 (+)	0.0	1.0	0.3	0.0	0.5
Albania	1.0	0.0	0.0	1.0	0.0	1.0	0.0	0.7	1.0	0.5
FYR Macedonia	0.0	0.0	0.0	1.0	0.0	0.0	1.0	0.0	2.0 (+)	0.4
Tajikistan	0.3 (+)	0.3 (+)	1.7 (+)	0.0	0.7 (+)	0.0	0.0	0.0	...	0.4
Croatia	1.0	0.0	0.0	0.0	1.0	1.0	0.0	0.3	0.0 (-)	0.4
Estonia	1.0	0.0	0.0	1.0	0.0	0.0	0.3	1.0	0.0 (-)	0.4
Uzbekistan	0.0	-0.7 (-)	-0.3	1.0	1.0	0.0	1.0	0.0	1.0	0.3
Poland	1.0	0.3 (+)	1.0	0.3	0.0	0.0	0.3 (+)	0.3	0.0	0.3
Slovenia	1.0	0.0	1.0	1.0	0.0	0.0	0.0	0.0	0.0	0.3
Turkmenistan	1.0	0.0	0.0	0.7 (-)	0.7	0.0	0.0	0.0	...	0.3
Lithuania	0.0	0.0	0.0	0.0	1.0	0.3	1.0	0.3	0.0	0.3
Kyrgyzstan	0.0	0.0	1.0	0.0	0.0	0.0	0.7	0.0	0.0	0.2
Slovakia	1.0	0.0	1.0 (+)	1.0	0.0	0.0	0.0	-0.7	-1.0 (-)	0.1
Russia	1.0	-0.3 (-)	-0.7 (-)	0.3	0.0	0.3	0.0 (-)	-0.3 (-)	1.0	0.1
Czech Republic	1.0	0.0	0.0 (-)	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Belarus	0.0	-1.0 (-)	0.0	-1.0	-1.0	0.0	0.0	0.3 (+)	-1.0	-0.4
CEE & NIS	0.9	-0.1 (-)	0.3 (-)	0.6	0.3	0.2	0.4 (-)	-0.1 (-)	0.8 (+)	0.4
Northern Tier CEE	1.0	0.2 (+)	0.7 (-)	0.4	0.1	0.0	0.3 (+)	0.2	0.0 (-)	0.3
Southern Tier CEE	0.6 (+)	0.0	0.0	0.9	0.2	0.7	0.5 (-)	0.1	1.7 (+)	0.5
NIS	1.0	-0.2 (-)	0.3 (-)	0.6	0.4	0.2	0.4 (-)	-0.1 (-)	0.9 (+)	0.4
Benchmark										0 or greater

Note: The sub-headings refer to the following economic reforms: (SSP) small-scale privatization; (PL) price liberalization; (TFE) trade and foreign exchange reforms; (LSP) large-scale privatization; (ER) enterprise restructuring; (CP) competition policy; (BR) bank reforms; (CM) capital market reforms; and (LR) legal reforms. The change is based on a rating from 1 to 5, e.g., a "1" represents a policy advancement by a full increment since the previous time period. For most of the indicators, the figures represent change (or absence of change) from 1994 to 1998; for price liberalization, competition policy, legal reforms, and non-bank financial reform indicators, from 1995 to 1998. A (+) represents an advancement from August 1997 to September 1998, a (-) represents a deterioration during that same period; (-) represents a deterioration > 1.0.

EBRD, *Transition Report 1998* (November 1998), and previous editions of the EBRD report.

B. Democratization

Progress towards democracy building is assessed from indicators drawn from Freedom House. First, the status and the change from 1991 through end-year 1998 in political rights and civil liberties are examined. Second, 1997-1998 democratic trends are further disaggregated and reviewed. As with the economic reforms, sufficient progress must entail both an adequate threshold as well as no significant deterioration.

Political Rights and Civil Liberties. Six primary criteria go into the determination of *political freedoms*: (1) the extent to which elections for head of government are free and fair; (2) the extent to which elections for legislative representatives are free and fair; (3) the ability of voters to endow their freely elected representatives with real power; (4) the openness of the system to competing political parties; (5) the freedom of citizens from domination by the military, foreign powers, totalitarian parties, and other powerful groups; and (6) the extent to which minority groups have reasonable self-determination and self-government.

Greater political liberties are both part of the end objective of a sustainable transition as well as a means to facilitate the economic reforms needed to achieve the transition. Arguably, the most credible route must be one, which is facilitated by an open, and competitive political system at all levels of government. This system must be sustained by broad-based participation from the electorate, and this electorate must have genuine influence on the course of political events. Such a route may not be the most rapid means of change, but it is by definition the most agreeable means among the citizens and hence likely the most sustainable.

Ten primary criteria go into the determination of *civil liberties*: (1) freedom of media, literature, and other cultural expressions; (2) existence of open public discussion and free private discussion including religious expressions; (3) freedom of assembly and demonstration; (4) freedom of political or quasi-political organization (which includes political parties, civic associations, and ad hoc issue groups); (5) equality of citizens under law with access to independent, nondiscriminatory judiciary; (6) protection from political terror and freedom from war or insurgency situations; (7) existence of free trade unions, professional organizations, businesses or cooperatives, and religious institutions; (8) existence of personal social freedoms, which include gender equality, property rights, freedom of movement, choice of residence, and choice of marriage and size of family; (9) equality of opportunity; and (10) freedom from extreme government indifference and corruption.

Civil liberties are the freedoms to develop views, institutions, and personal autonomy apart from the state. The development of civil liberties, like political liberties, is an end objective in itself. The merits of such liberties as freedom of assembly and open public discussions, and freedom from political terror and war are self-evident.

However, greater civil liberties can also serve as a crucial counterweight or check on governments in societies where political rights are lacking. This counterweight can be found among NGOs (such as free trade unions, professional organizations, and religious institutions) as well as a free media. An independent, nondiscriminatory judiciary is critical for similar reasons.

In addition, civil liberties tend to link quite closely with economic progress. Many--such as greater equality of opportunity, freedom from corruption, the existence of personal social freedoms such as gender equality, property rights, freedom of movement--contribute to a more productive economy as well as a more just one. Similarly, through the political process, pressures from civil society can help push economic reforms along.

Table 4 below highlights Freedom House's assessments of political rights and civil liberties from 1991 through 1998. The range in progress in democratization across the countries is great. At one extreme, there now exist seven transition countries--the Czech Republic, Estonia, Hungary, Lithuania, Poland, Slovenia, and most recently, Latvia--where political rights and civil liberties are roughly comparable to those found in Western Europe (such as in France, Germany, Italy, and the UK). Three of these countries--the Czech Republic, Hungary, and Slovenia--have maintained this level of freedom since at least 1993. Poland and Lithuania achieved this level in 1995, Estonia in 1996, and Latvia in 1997. Of these seven countries, only Latvia and Estonia experienced a temporary relapse in democratic freedoms since 1991.

Among these leaders, democracy and freedom prevail. Elections are free and fair, at the national and sub-national levels. Those elected rule. There are competitive political parties, and the opposition has an important role and power. By and large, minority groups have self-determination. In general, there remain deficiencies in some aspects of civil liberties, though most such freedoms exist. The media are generally free. The judiciary is generally independent and nondiscriminatory. NGOs and trade unions are free and able to exist. Personal social freedoms exist, as does freedom from extreme government indifference and corruption.

In contrast, Turkmenistan is among a handful of countries worldwide rated by Freedom House to have the fewest political rights and civil liberties in 1998; one of only thirteen countries out of 191 countries to receive the poorest score. Democratic freedoms in Uzbekistan, Tajikistan, Belarus, and Yugoslavia are not much greater than those in Turkmenistan.

In Turkmenistan and Uzbekistan, basic political rights are nonexistent. In the other democratic laggards, the regimes may allow some minimal manifestation of political rights such as competitive local elections or some sort of representation or partial autonomy for minorities. An independent civic life, including a free media, is effectively suppressed in Turkmenistan. In the other lagging countries, people experience severely restricted expression and association.

Evidence provided in *Monitoring Country Progress* (October 1998) revealed a growing gap in democratic freedoms between the transition leaders and laggards. The latest data show that this trend continues. 1998 trends (as shown in “arrows” in *Table 4*) reveal a split: those countries that experienced an increase in democratic freedoms in 1998 are all in the top half of the democratization rankings; those that experienced a decrease in freedoms are in the bottom half.

The subregional trends in 1998 are as follows. Two countries of the Northern Tier CEE experienced some measurable increase in 1998 in democratization. None witnessed deterioration. Slovakia experienced the biggest gains; a jump in Freedom House’s civil liberties rating by two scores. This was attributed to a more free media environment and to anti-corruption efforts. Latvia achieved a more modest increase in freedom, due to further liberalization of the country’s citizenship law. It’s helpful to bear in mind that all the Northern Tier CEE countries, except Slovakia, have approached a “ceiling” in democratization; that is, there is relatively little room for improvement, particularly in political rights, as judged by worldwide standards.

The Southern Tier CEE countries experienced more backsliding than progress in democratic freedoms in 1998. Events in Macedonia were the exception. Political rights in Macedonia in 1998 increased due to an election process in the fall of 1998 that was characterized by free and fair elections with a high voter turnout and constructive and inclusive pre-election debates, and a new government coalition which included representation from the ethnic Albanian community.

In contrast, three Southern Tier CEE countries witnessed some measurable decrease in civil liberties in 1998. In Yugoslavia, there was a violent crackdown in Kosovo, a repressive media law, and purges in universities, police, and the army. In Albania, there was increased civil unrest and corruption. Corruption also increased in Croatia, as did harassment of the press. Failure to repatriate refugees also characterized civil liberties in Croatia in 1998.

There was greater measurable change in democratic freedoms in the NIS countries than in the CEE countries in 1998, and most of it was backsliding. The exception to the trend occurred both in Moldova and Armenia. Freer parliamentary elections in 1998 contributed to greater political rights in Moldova. In Armenia, political rights increased as a result of the legalization of the leading opposition party and reasonably free presidential elections.

Democratic freedoms decreased in five NIS countries in 1998. Kyrgyzstan experienced the greatest deterioration in 1998; both political rights and civil liberties decreased due to increased authoritarianism of the executive and greater corruption. In Azerbaijan, there were unfair presidential elections, a renewed crackdown on the opposition, and an increase in corruption. In Kazakhstan, there was an unfair presidential campaign and persecution of the opposition. Political rights in Russia also decreased due broadly to a further weakening of government coincident with growing corruption and lawlessness. The assassination of a leading opposition parliamentarian, Galina Stratovoitova, in

November 1998 dramatically underscored the lawlessness in Russia. Finally, freedoms in Tajikistan were further restricted in 1998 due to renewed violence, armed insurrection, and assassinations.

Most of the change in democratization in 1998 was in political rights in the NIS countries and in civil liberties in the CEE countries.

Table 4 confirms that the growing gap in democratization between the subregions has been ongoing for much of the transition. Since 1991, eight of the twelve NIS countries have experienced a decrease in democratic freedoms; only Georgia, Moldova, and Armenia have witnessed an overall increase. Of the fifteen CEE countries, only in Albania and Yugoslavia are there fewer democratic freedoms today than there were in the early transition years (1991-1993). However, three other Southern Tier CEE countries have experienced no net gains in democratization since then: Croatia, Bulgaria, and Macedonia. Freedoms have increased in eight CEE countries during 1991-1998. Six of these countries are Northern Tier CEE; the other two Northern Tier countries (the Czech Republic and Slovenia) had already achieved a level of democratic freedom on a par with Western Europe by 1992-1993.

Democratization Disaggregated. In its *Nations in Transit 1998* (October 1998), Freedom House further disaggregated democratization trends in the region. *Table 5* displays this effort. Six components of democracy building are rated on a one-to-seven scale in each country. The ratings represent events as of early April 1998 and are compared with progress at the end of 1996. While these ratings are less current than the political rights and civil liberties scores of *Table 4*, they provide a more complete picture of the components of democratization in the region.

The *political process* focuses on elections, party configuration, political competition, and popular participation in elections. *Civil society* assesses the status of nongovernmental organizations; the number and nature of NGOs, and the degree of participation.

Independent media attempts to measure freedom from government control (such as legal protection, editorial independence, and the extent of privatization) and the financial viability of private media. *Governance and public administration* focuses on legislative and executive effectiveness, and on government decentralization, including the independence and effectiveness of local and regional government. *Rule of law* examines constitutional reforms, the development and independence of the judiciary, and the rights of ethnic minorities. Finally, the scope of *corruption* (official corruption in civil service; public-private sector links; anti-corruption laws and decrees adopted and enforced) is also assessed.

As expected, general trends between Freedom Houses' two rating schemes coincide; the country rankings, in particular, are quite similar between the two schemes. The Northern Tier CEE countries are far out front in democratization. The laggards consist of most of the Central Asian Republics plus Belarus, as well as the Southern Tier CEE countries of Bosnia-Herzegovina, Yugoslavia, and, to a lesser extent, Albania. In fact, the more disaggregated scheme of *Table 5* shows a larger gap between the Northern Tier leaders

and the rest, as well as greater differentiation within the Northern Tier CEE countries. Part of these differences in degree stem from greater weight given to the scope of corruption in the disaggregated ratings.

The trends over time (from early 1997 to April 1998) as shown in *Table 5* roughly conform to the most recent trends (through end-year 1998) of *Table 4*. In particular, more countries in 1997 through early 1998 witnessed a decrease in democratic freedoms (ten countries) than an increase (six countries).⁶ Moreover, none of the backsliding occurred in the transition leaders, and, in fact, a number of them showed advances. In contrast, broad-based losses occurred in several NIS countries (Russia, Ukraine, and Belarus, in particular) as well as in Albania. Only three countries--Kazakhstan, Moldova, and Georgia--experienced mixed results; that is, gains in one or more areas alongside losses in others.

Judging from *Table 5*, the NIS countries lag most in democratization vis-a-vis the Northern Tier CEE leaders in the severity of corruption (and the government's commitment to address it), followed by progress towards developing an independent (financially viable) media. The progress gaps in civil society development, political process, rule of law, and (primarily local) governance/public administration are smaller and roughly comparable to each other. Even so, most of these democratic components have been deteriorating in much of the NIS since 1997.

⁶ This reverses a more favorable trend in 1996 (when nine countries had an increase in freedoms and five a decrease).

Table 4. Political Rights and Civil Liberties¹

	1991		1994		1998²		1994-98 Change³		1991-98 Change⁴	
	PR	CL	PR	CL	PR	CL	PR	CL	PR	CL
Czech Republic	...	...	1	2	1	2	0	0	0	0
Hungary	2	2	1	2	1	2	0	0	+ 1	0
Slovenia	...	...	1	2	1	2	0	0	0	0
Poland	2	2	2	2	1	2	+ 1	0	+ 1	0
Lithuania	2	3	1	3	1	2	0	+ 1	+ 1	+ 1
Estonia	2	3	3	2	1	2	+ 2	0	+ 1	+ 1
Latvia	2	2	3	2	1	2↑	+ 2	0	+ 1	0
Romania	5	5	4	3	2	2	+ 2	+ 1	+ 3	+ 3
Slovakia	...	...	2	3	2	2↑↑	0	+ 1	+ 1	+ 2
Bulgaria	2	3	2	2	2	3	0	- 1	0	0
FYR Macedonia	...	...	4	3	3↑	3	+ 1	0	0	0
Moldova	5	4	4	4	2↑	4	+ 2	0	+ 3	0
Ukraine	3	3	3	4	3	4	0	0	0	- 1
Georgia	6	5	5	5	3	4	+ 2	+ 1	+ 3	+ 1
Croatia	...	...	4	4	4	4↓	0	0	0	0
Armenia	5	5	3	4	4↑	4	- 1	0	+ 1	+ 1
Russia	3	3	3	4	4↓	4	- 1	0	- 1	- 1
Albania	4	4	3	4	4	5↓	- 1	- 1	0	- 1
Azerbaijan	5	5	6	6	6↓	4	0	+ 2	- 1	+ 1
Bosnia-Herzegovina	...	...	6	6	5	5	+ 1	+ 1	+ 1	+ 1
Kyrgyzstan	3	4	4	3	5↓	5↓	- 1	- 2	- 2	- 1
Kazakhstan	5	4	6	5	6↓	5	0	0	- 1	- 1
Yugoslavia	...	...	6	6	6	6↓	0	0	0	- 1
Tajikistan	5	5	7	7	6	6↓	+ 1	+ 1	- 1	- 1
Belarus	4	4	4	4	6	6	- 2	- 2	- 2	- 2
Uzbekistan	6	5	7	7	7	6	0	+ 1	- 1	- 1
Turkmenistan	6	5	7	7	7	7	0	0	- 1	- 2
Region	1991		1994		1998		1994-98 Change		1991-98 Change	
	PR	CL	PR	CL	PR	CL	PR	CL	PR	CL
CEE & NIS	3.5	3.4	3.5	3.9	3.6	3.8	- 0.1	+ 0.1	- 0.2	- 0.4
Northern Tier CEE	2.0	2.1	1.7	2.1	1.1	2.0	+ 0.6	+ 0.1	+ 0.9	+ 0.1
Southern Tier CEE	4.2	4.4	4.2	3.2	3.3	2.9	+ 0.8	+ 0.3	+ 0.9	+ 1.5
NIS	3.7	3.5	3.8	4.5	4.4	4.4	- 0.5	+ 0.1	- 0.7	- 0.9
European Union⁵					1.0	1.5				
OECD⁶					1.2	1.7				
Benchmarks					1.0	2.0	0.0	0.0		

Notes: ¹Ratings from 1 to 7, with 1 representing greatest development of political rights/civil liberties. ²An ↑ indicates an increase in democratization in 1998. ³A "+" refers to an increase in freedoms. ⁴The change for Bosnia-Herzegovina, Croatia, FYR Macedonia, Slovenia and Yugoslavia (Serbia & Montenegro) is calculated from 1992 to 1998; this series for the Czech Republic and Slovakia covers from 1993 to 1998. ⁵All 15 EU members score "1" in Political Rights. In Civil Liberties 8 of the 15 members score a "1"; 6 score a "2" (Belgium, France, Germany, Italy, Spain and the UK); and Greece scores a "3". ⁶All but three OECD members score a "1" in Political Rights; the exceptions are Turkey ("4"), Mexico ("3"), and Korea ("2"). For Civil Liberties, 15 members score a "1"; 11 score a "2" (Belgium, Czech Republic, France, Germany, Hungary, Italy, Japan, Korea, Poland, Spain, and the UK); Greece scores a "3"; Mexico scores a "4"; Turkey scores a "5"

Freedom House, *Freedom in the World: 1998-1999* (May 1999).

Table 5. Democratization Disaggregated

Country	Political Process	Civil Society	Independent Media	Govt/Public Administration	Rule of Law	Corruption	Average	% Change Since 1996
Poland	1.3 ↑	1.3	1.5	1.8	1.5	1.0	1.4	0%
Hungary	1.3	1.3	1.5	1.8	1.8	1.0	1.5	0%
Slovenia	2.0	2.0	1.8	2.5	1.5 ↑	1.0	1.8	0%
Czech Republic	1.3	1.5	1.3	2.0	1.5	3.0	1.8	0%
Lithuania	1.8 ↑	2.0 ↑	1.5 ↑	2.5	2.0 ↑	3.0	2.1	9%
Estonia	1.8 ↑	2.3	1.8	2.3	2.3	3.0	2.3	0%
Latvia	2.0	2.3	1.8	2.5	2.3	3.0	2.3	0%
Bulgaria	2.8 ↑	3.8 ↑	3.5 ↑	4.0 ↑	3.8 ↑	5.0	3.8	8%
Slovakia	3.5 ↑	3.0 ↑	4.0 ↑	3.8	4.0	5.0	3.9	3%
FYR Macedonia	3.5	3.8	4.0	4.0	4.5 ↓	5.0	4.1	-3%
Romania	3.3	3.8	4.0 ↑	4.0 ↑	4.3	5.0	4.1	3%
Moldova	3.5 ↓	3.8	4.3 ↓	4.5 ↓	4.0 ↑	5.0	4.2	-3%
Croatia	4.3 ↓	3.5	4.8	4.0	4.8	5.0	4.4	-2%
Russia	3.5	4.0 ↓	4.3 ↓	4.5 ↓	4.3 ↓	7.0	4.6	-8%
Georgia	4.5 ↑	4.3 ↑	4.3 ↑	5.0 ↓	4.8 ↑	5.0	4.7	2%
Ukraine	3.5 ↓	4.3 ↓	4.8 ↓	4.8 ↓	4.0 ↓	7.0	4.7	-8%
Kyrgyzstan	5.0	4.5	5.0	4.5 ↓	4.5	7.0	5.1	0%
Albania	4.5 ↓	4.3	4.8	5.0 ↓	5.3 ↓	7.0	5.2	-4%
Armenia	5.8 ↓	3.5	5.3	4.5	5.0 ↓	7.0	5.2	-2%
Yugoslavia	5.0	5.0	4.5	5.0	5.0	7.0	5.3	...
Kazakhstan	5.5	5.0 ↑	5.5 ↓	5.5	5.3 ↓	7.0	5.6	-2%
Azerbaijan	5.5 ↑	5.0	5.5	6.3	5.5	7.0	5.8	0%
Belarus	6.3 ↓	5.8 ↓	6.5 ↓	6.3 ↓	6.3 ↓	5.0	6.0	-5%
Bosnia-Herzegovina	6.0	6.0	6.3	6.5	6.5	5.0	6.1	...
Tajikistan	5.8 ↑	5.3 ↑	6.0 ↑	6.8 ↑	6.0 ↑	7.0	6.2	3%
Uzbekistan	6.5 ↓	6.5	6.5	6.3 ↓	6.5	7.0	6.6	-2%
Turkmenistan	7.0	7.0	7.0	6.8	6.8	7.0	6.9	0%
CEE & NIS	3.6	3.9 ↓	4.2 ↓	4.3 ↓	4.1 ↓	5.7	4.3	-4%
Northern Tier CEE	1.5 ↑	1.6	1.7	2.1	1.8	1.8	1.7	1%
Southern Tier CEE	3.4 ↑	3.8	4.1 ↑	4.1 ↑	4.3 ↑	5.2	4.2	3%
NIS	4.2 ↓	4.5 ↓	4.9 ↓	5.0 ↓	4.7 ↓	6.9	5.0	-6%

Note: On a scale from 1 to 7, with 1 representing most free. A "↑" indicates an increase in democratization since 1996; a "↓" signifies a decrease. Data cover from 1997 through April 1, 1998. A positive percentage change denotes an improvement since 1996. Change calculation does not include corruption component, as data on corruption were not previously available from Freedom House. Ratings for Bosnia-Herzegovina and Yugoslavia are provided for the first time in this issue of *Nations in Transit*.

Source: Freedom House, *Nations in Transit 1998* (October 1998).

C. Summary of Economic Reforms & Democratization

Table 6 and the *Summary Figure* provide an overall picture of the status of the economic policy reforms and democratic freedoms in the transition countries. With one country exception, the economic policy reform ratings represent an equally weighted average of all twelve EBRD policy indicators (that is, from both stages).⁷ The democratic freedom ratings draw from both Freedom House sources. Specifically, the six democratization components of *Table 5* are averaged for each country, and then compressed to a one-to-five scale with five representing the most free. This is to better align with the similar economic policy reform scale. These scores are then adjusted with the more recent 1998 democracy trends of *Table 4*.⁸ The use of both Freedom House scores combines a more accurate differentiation of democratic progress between countries (from *Table 5*) with the latest changes in trends (from *Table 4*).

The *Summary Figure* suggests three country groups differentiated by progress towards economic and democratic reforms. At either end of the reform spectrum are two fairly well defined groups. The Northern Tier CEE countries (less Slovakia) are well out front, particularly in democratic reforms. Hungary is on top. The least advanced group is a small one that includes three Central Asian Republics (Turkmenistan, Tajikistan, and Uzbekistan), Belarus, and Bosnia-Herzegovina.

The middle group is the largest and the least well defined (or, the most diverse in terms of reform progress). This group includes the Southern Tier CEE countries (less Bosnia-Herzegovina), Russia, Ukraine and other NIS countries.

Slovakia and Azerbaijan look to be the outliers. Azerbaijan is between the middle and the least advanced group. Slovakia is between the middle and the most advanced group. Slovakia's outlier status, however, may be changing. Slovakia progressed significantly in democratic reforms in 1998, and moved closer to the Northern Tier leaders in that regard. It looks to be currently moving ahead in economic reforms as well.

Table 6 shows that while the average ratings for economic policy reforms and democratic freedoms are the same for the transition region as a whole (that is, "2.7" out of a possible "5" for each), the variation in progress is significantly greater in the case of democratic reforms. The reform leaders have democratic freedoms roughly on a par with some Western democracies, while the democratic laggard, Turkmenistan, scores among the least

⁷ The economic reform score for Yugoslavia is drawn from Freedom House, *Nations in Transit* (October 1998). *Monitoring Country Progress* (October 1998) elaborates on Freedom House's methodology and compares its economic reform rating scheme with the EBRD scores.

⁸ Country ratings were increased (decreased) by 0.4 if democratic freedoms (either political rights and/or civil liberties) increased (decreased) by 2 Freedom House scores. This happened only to Slovakia (CL increased by 2) and Kyrgyzstan (CL and PR both decreased by one). Country ratings were increased (decreased) by 0.2 if democratic freedoms increased (decreased) by 1 FH score. Such increases occurred in Macedonia, Moldova, & Armenia; comparable decreases occurred in Russia and Albania. Finally, country ratings were increased (decreased) by 0.1 if FH indicated a trend toward improvement or decline in freedom, but not of sufficient magnitude to change a country's rating from the previous year, 1997. This meant an increase to Latvia, and decreases to Croatia, Azerbaijan, Kazakhstan, Yugoslavia, and Tajikistan.

democratic countries worldwide. In economic policy reforms, however, even the Northern Tier CEE countries still have far to go to reach the standards in the industrial market economies. This is particularly evident in the second stage economic reforms.

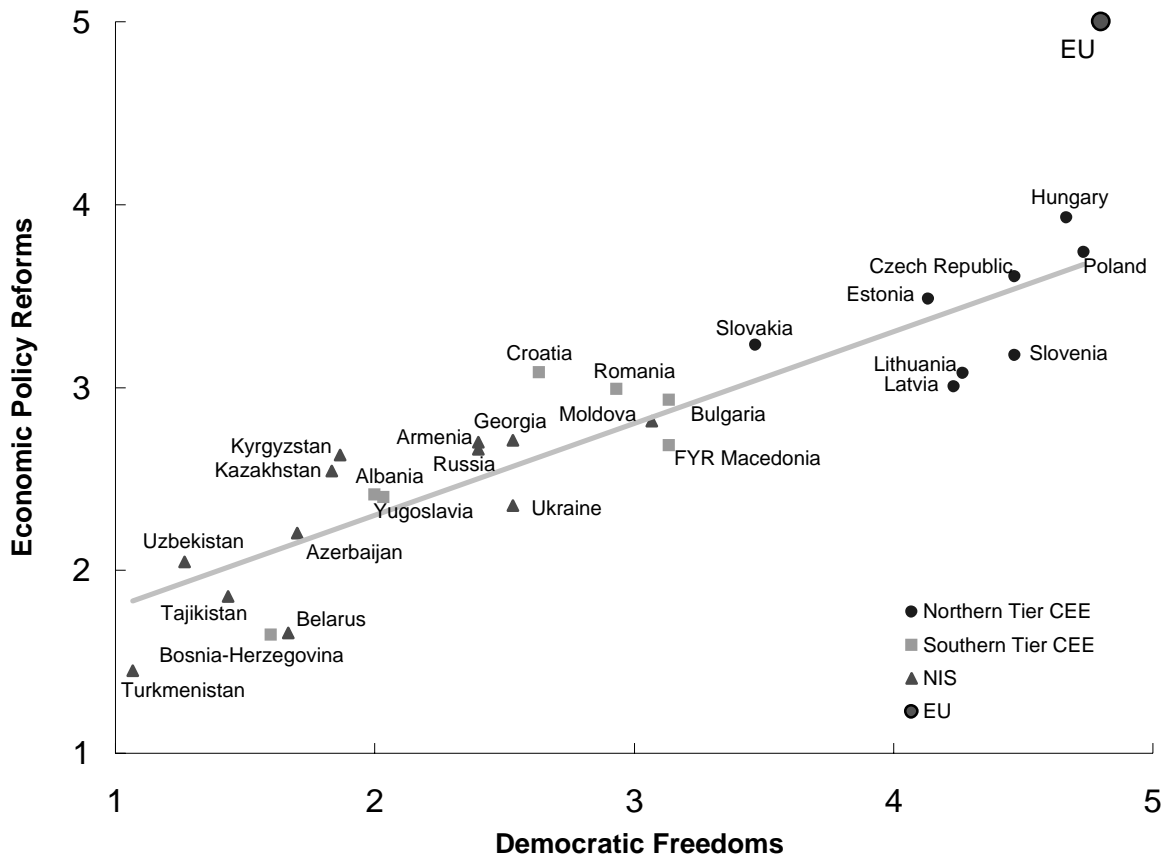
There appears to be a close correspondence between progress in economic and democratic reforms. Greater progress in one domain is closely associated with greater progress in the other. In fact, *Table 6* shows very little difference in country rankings between economic and democratic reforms. Croatia and Ukraine are the biggest exceptions, and show the largest "imbalance." Croatia is relatively further ahead in economic reforms: it ranks seventh in economic reforms and thirteenth in democratic reforms. Ukraine is the reverse. It ranks fourteenth in democratic reforms, but only nineteenth in economic reforms.

If there is an emerging trend that is suggested by the recent reform changes, it may be that the middle group of reformers is "spreading out." That is, there may be growing differentiation in reform progress in this group. This observation is supported by the most recent Freedom House data on democratic changes and looks to be broadly supported by EBRD's ratings of economic reform changes in its November 1998 report, and underscored by its more recent qualitative assessments in its April 1999 report.

More specifically, those countries that are closer to the least advanced group of countries have recently moved closer still. This likely includes Albania, Yugoslavia, Russia, and Ukraine, and possibly Azerbaijan, Kazakhstan, and Kyrgyzstan as well. In addition, some of the countries that are leading the middle group have recently moved closer to the most advanced reform country group. In addition to Slovakia, this has included Macedonia and Moldova, and possibly Bulgaria.

Finally, there is a close relationship between overall reform progress and geography. Broadly, the closer a country is to Western Europe, the more advanced it is in its reforms.

Summary Figure. Economic Policy Reforms and Democratic Freedoms in Central & Eastern Europe and the New Independent States: 1998



Ratings of democratic freedoms are from Freedom House, *Nations in Transit 1998* (October 1998) and Freedom House, *Freedom in the World 1998-1999* (June 1999), and assess reforms through December 1998. With 1 exception, economic policy reform ratings are from EBRD, *Transition Report 1998* (November 1998), and cover events through early September 1998; economic policy reform rating for Yugoslavia is from Freedom House (October 1998). Ratings are based on a 1 to 5 scale, with 5 representing most advanced.

Table 6. Economic Policy Reforms and Democratic Freedoms in Central & Eastern Europe and the New Independent States: 1998

<u>Economic Policy</u>			<u>Democratic Freedoms</u>		
Country	Rating (1 to 5)	Ranking	Country	Rating (1 to 5)	Ranking
Hungary	3.9	1	Hungary	4.7	1
Poland	3.7	2	Poland	4.7	1
Czech Republic	3.6	3	Czech Republic	4.5	3
Estonia	3.5	4	Slovenia	4.5	3
Slovakia	3.2	5	Lithuania	4.3	5
Slovenia	3.2	5	Latvia	4.2	6
Croatia	3.1	7	Estonia	4.1	7
Lithuania	3.1	7	Slovakia	3.5	8
Latvia	3.0	9	Bulgaria	3.1	9
Romania	3.0	9	FYR Macedonia	3.1	9
Bulgaria	2.9	11	Moldova	3.1	9
Moldova	2.8	12	Romania	2.9	12
Georgia	2.7	13	Croatia	2.6	13
Armenia	2.7	13	Georgia	2.5	14
FYR Macedonia	2.7	13	Ukraine	2.5	14
Russia	2.7	13	Armenia	2.4	16
Kyrgyzstan	2.6	17	Russia	2.4	16
Kazakhstan	2.5	18	Yugoslavia	2.0	18
Albania	2.4	19	Albania	2.0	18
Yugoslavia	2.4	19	Kyrgyzstan	1.9	20
Ukraine	2.4	19	Kazakhstan	1.8	21
Azerbaijan	2.2	22	Azerbaijan	1.7	22
Uzbekistan	2.0	23	Belarus	1.7	22
Tajikistan	1.9	24	Bosnia-Herzegovina	1.6	24
Belarus	1.7	25	Tajikistan	1.4	25
Bosnia-Herzegovina	1.6	26	Uzbekistan	1.3	26
Turkmenistan	1.5	27	Turkmenistan	1.1	27
Rating (1 to 5)			Rating (1 to 5)		
CEE & NIS			2.7		
Northern Tier CEE			4.5		
Southern Tier CEE			2.8		
NIS			2.2		
European Union			4.8		
OECD			4.6		

Ratings of democratic freedoms are from Freedom House, *Nations in Transit 1998* (October 1998) and Freedom House, *Freedom in the World 1998-1999* (June 1999), and assess reforms through December 1998. With 1 exception, economic policy reform ratings are from EBRD, *Transition Report 1998* (November 1998), and cover events through early September 1998; economic policy reform rating for Yugoslavia is from Freedom House (October 1998). Ratings are based on a 1 to 5 scale, with 5 representing most advanced.

D. Sustainability

In this section, we weigh the economic and democratic reforms with the macroeconomic and microeconomic evidence. Economic policy reforms need to translate into good macroeconomic performance. Yet, this is not enough. The benefits at the macro level must also be reasonably well distributed and need to translate into social conditions that at the least are not significantly deteriorating. Otherwise, the reforms may stall for lack of support, or fiscal sustainability may be jeopardized, or, even more fundamentally, overall productivity may be slowed.

It merits stating that the quality of these data is often questionable. Credible comparisons across time and across countries are sometimes difficult. In general, data for CEE are better than that for the NIS, and much of the economic data are likely better than much of the social data. Conclusions should be based on a variety of evidence if possible.

1. Macroeconomic Performance.

Tables 7 through 13 highlight macroeconomic performance. Fundamental to sustaining reforms is sustained **economic growth** at some moderate rate or greater. As evident in *Table 7*, the Northern Tier countries have been achieving this, at growth rates of close to four percent or more from 1994-1998. This has been well above EU growth rates. However, the more recent 1997-1999 trend reveals economic growth slowing considerably; from 5.7 percent in 1997 to 3.7 percent in 1998 and perhaps to 2.5 percent in 1999. Some of this can likely be attributed, at least indirectly, to the global financial crisis.⁹ The Baltic countries, particularly Latvia and Lithuania, experienced slower economic growth in 1998 due to close ties to a Russia in crisis. Moreover, due to close trade links with the EU, all the countries of the Northern Tier are witnessing slower growth in 1999 as economic growth in Western Europe slows, and with it, demand for Northern Tier CEE exports.

Highest sustained economic growth among the Northern Tier CEE countries has occurred in Estonia, Poland, and Slovakia, with 1996-1998 growth rates of close to six percent or higher. More recently, in 1998 to the present, Hungary's growth has been the highest. Economic expansion in Hungary and Poland has been fueled by double-digit investment growth and strong export growth. Economic expansion in Estonia and Slovakia, in contrast, has recently slowed due in part to policy adjustments to temper large macroeconomic imbalances, i.e., very high current account deficits in both countries, as well as a high fiscal deficit in Slovakia.

The Czech Republic continues to be the Northern Tier laggard in economic growth. In fact, the economy contracted by almost three percent in 1998, and it is not expected to grow in 1999. This comes in the context of falling investment and private consumption, and very little progress in moving forward on structural reforms.

⁹ *Appendix II* elaborates.

For the Southern Tier CEE as a whole, strong economic growth in 1994-1996 has given way to economic contraction in 1997-1999. This turn around is largely due to economic and political troubles in Romania, and more recently, the Kosovo crisis. Still, the (population-weighted) subregional average masks wide diversity. While Albania, Bulgaria, and Romania all experienced substantial economic contractions in 1997, the economies of Albania and Bulgaria rebounded impressively in 1998, eight percent in Albania, and 2.5 percent in Bulgaria. Bulgaria's rebound, in particular, was a reflection of significant reform progress to stabilize the economy and to restructure the financial system. Moreover, 1998 represented the first transition year of relatively robust growth (of three percent) for Macedonia. Bosnia-Herzegovina has been expanding at a very rapid pace (18 percent in 1998), though this has been fueled by significant external assistance, and is also partly a response to a dramatic collapse in the economy several years back.

Romania's economy, in contrast, contracted by close to seven percent in 1997 and more than seven percent in 1998, and is expected to continue to decline in 1999. This comes in the context of continued political tensions, slow progress in structural reforms, and continued difficulties in making foreign debt payments.

Macroeconomic performance in the Southern Tier in 1999 is dominated by the spillover from the Kosovo crisis.¹⁰ Hardest hit in terms of economic growth will likely be Macedonia, Bulgaria, and Croatia.

1997 represented the first year of economic growth for the NIS on average since the transition began. Due largely to the Russian financial crisis and its spillover to the region, overall economic expansion was not repeated in 1998; nor will it be repeated in 1999. In fact, contraction in 1999 for the NIS (estimated at -2.8 percent) will be greater than in 1998 (-1.9 percent). The Russian economy contracted by 4.6 percent in 1998, and will likely shrink by a similar percent in 1999 (perhaps by five percent).

Close economic ties to a Russia in crisis and sharply falling prices of commodity exports have contributed to sharply lower economic growth in many NIS countries. Most affected by close economic ties to Russia include Moldova, Ukraine, Kazakhstan, and Kyrgyzstan. The economies of Moldova, Ukraine, and Kazakhstan all contracted in 1998 and are still contracting. Ukraine has yet to experience economic growth since communism's collapse.

Oil prices fell by thirty percent in 1998 and non-fuel commodities (including cotton and various metals) by over fifteen percent. Export revenues and hence economic growth suffered consequently in many the NIS countries: Turkmenistan (energy and textiles), Uzbekistan (textiles), Russia (energy and metals), Azerbaijan (energy and textiles), Tajikistan (textiles), Kazakhstan (energy and metals), and Kyrgyzstan (metals).

¹⁰ *Appendix II* elaborates.

Still, the majority (eight) of the NIS experienced growing economies in 1998, as was the case in 1996 and 1997, and may likely be the case in 1999 (perhaps seven countries). Highest growth over the medium term (three years or so) has occurred in the three Caucasus countries as well as in Belarus and Kyrgyzstan. Of these countries, factoring in 1999 estimates, perhaps only Armenia and Azerbaijan can be characterized as experiencing sustained robust economic growth. In general, recent trends have underscored significant vulnerabilities to external events in most NIS countries to achieve, let alone sustain, economic growth.

Annual **inflation** rates much above the single-digit range erode business confidence, and the ability and incentive to invest and expand at the enterprise level. Inflation trends vary widely between the CEE and NIS countries (*Table 8*). Inflation continues to fall in most of the CEE countries, and eight of these countries have now sustained three years of single-digit inflation rates: Bosnia-Herzegovina; Macedonia; Croatia; Slovakia; Latvia; Lithuania; Slovenia; and the Czech Republic. Inflation rates in 1998 were equal to or less than ten percent for all CEE countries except Romania (where it was forty percent). The decline in inflation among the Northern Tier CEE countries has been a steady, incremental trend. From 1994-1998, it has fallen on average about four to five percentage points annually, and is now close to an annual rate of only eight percent. In the Southern Tier CEE, inflation fell significantly in Bulgaria, Albania, and Romania in 1998 after sharp increases in all three countries in 1997. It is still too high in Romania, and that pattern is likely to hold through 1999.

Recent trends in inflation rates in the NIS have largely been tied to exchange rate trends that in turn have been linked to economic turmoil in Russia. In particular, the large depreciation of the Russian ruble has contributed to depreciation of currencies in other NIS countries that are closely linked to Russia. More expensive imports, in turn, have filtered through these economies and, alongside fiscal imbalances, have contributed to inflation rate increases. Hence, higher inflation in Russia in 1998 was accompanied by increases in Georgia, Moldova, Kyrgyzstan, Ukraine, Belarus, and Turkmenistan. With a more recent devaluation of the currency in Kazakhstan, inflation will likely increase there as well in 1999 for similar reasons.

Overall, after falling significantly from triple-digit levels in the early to mid-1990s to nineteen percent in 1997, inflation has increased in the NIS to almost sixty percent in 1998, and is forecast to be higher in 1999 (at sixty-four percent). The weighted regional average is influenced heavily by trends in Russia where inflation was eighty-five percent in 1998 and is forecast to be ninety percent in 1999. While Russia's inflation is high, it is worthy to note that the concern among some observers of hyperinflation in Russia from the August 1998 devaluation and default (and anticipated money creation) proved unfounded.

Azerbaijan and Armenia stand out as the exceptions to the NIS inflation trends. Both have sustained single-digit inflation rates for at least three years. Both have also been able to maintain exchange rate stability, though at the cost of very tight monetary

conditions. Here, as in much of the CEE countries, relatively strong currencies have contributed to falling import prices and, with it, falling inflation.

Budget deficits (*Table 9*) that remain high fuel inflation and unproductive activity, particularly if financial markets are not well functioning. If in fact the financial markets are well established, high budget deficits may ultimately crowd out potential private sector investors from such markets. More generally, as witnessed in the case of Russia, persistently high budget deficits can seriously undermine investor confidence. With the recent development of securities markets, a number of countries have been able to finance deficits in a noninflationary manner at least in the short-term. But, such an approach is unsustainable if reducing the structural deficit is not tackled; all the more so if the share financed by foreign portfolio investors is significant.

While the fiscal balances overall for the transition region have improved substantially since the beginning of the transition, many countries still maintain unsustainably high deficits. Eight countries had fiscal deficits equal to or greater than five percent of GDP in 1998: four NIS (Kyrgyzstan, Moldova, Armenia, and Kazakhstan); two Northern Tier (Lithuania and Slovakia); and two Southern Tier (Romania and Albania).

Moreover, a majority of countries (fifteen) had deteriorating fiscal balances in 1998. All but Romania of the Southern Tier countries will likely experience deterioration in fiscal balances in 1999 due in large part to the Kosovo crisis.

On the other hand, there are ten countries with 1996-1998 fiscal balances, which equal or better the EU Maastricht target of a three percent deficit of GDP. Four of these are Northern Tier (Estonia, Latvia, Slovenia, and the Czech Republic), three Southern Tier (Bosnia-Herzegovina, Croatia, and Macedonia), and three NIS (Belarus, Turkmenistan, and Azerbaijan). Poland (at 3.1 percent) is very close to this benchmark.

Fiscal balance trends for Russia as reported by the EBRD look suspect. The fiscal deficit in 1998 is reported to be 3.6 percent of GDP, still high but down from five percent in 1997. Moreover, a surplus is forecast for 1999.

Table 10 shows trends in domestic investment and the share of the economies in private sector hands. The **private sector share of the economy** is a rough proxy for the extent of economic restructuring, either through the privatization process or the growth of new private-sector firms. Those economies which predominantly produce private sector output are much more likely to generate momentum towards greater economic expansion overall.

Nineteen countries of the region in fact now have a private sector generating at least fifty percent of GDP. The average for all of CEE and NIS is sixty-one percent. This represents very impressive gains; in 1989, the region's private sector share was probably closer to ten percent of GDP.

Most OECD economies have private sectors, which range from seventy to eighty-five percent of GDP. Seven transition countries (five Northern Tier countries, Russia, and Albania) now have private sectors that meet this threshold. The private sector share of GDP is highest in Hungary (at eighty percent). Slovenia's private sector as a share of GDP is fifty-five percent. This is the lowest among the Northern Tier countries, though perhaps not much different from that of its neighbors, Austria and Italy.

Six countries (all NIS) still have economies in which more than fifty percent of economic activity derives from the public sector. In Belarus, the public sector constitutes eighty percent of GDP.

Domestic investment (*Table 10*) contributes to the productive capacity of the economy and hence helps provide the momentum that is necessary for sustained economic expansion further down the road. Only five transition countries, four of which are Northern Tier, have experienced an increase in domestic investment as a percent of GDP from 1990-1997: Hungary; the Czech Republic; Slovakia; Croatia; and Slovenia. On average, domestic investment as a percent of GDP in the Southern Tier and NIS countries has fallen by roughly one-third during the transition. Of the three subregions, overall investment levels are highest in the Northern Tier CEE countries (26 percent of GDP) and lowest in the Southern Tier CEE countries (18 percent).

An important indicator of the extent to which firms are restructuring is the **productivity of labor**, or output per employee (*Table 11*). The efficiency gains from an increase in productivity would likely stem from a number of possibilities, including fewer excess workers, greater skilled and/or motivated workers, improved capital stock, and/or a greater capacity to manage.

Labor productivity growth in industry has been impressive in the Northern Tier CEE countries, but much less so most elsewhere for which data are available. Productivity growth has been close to ten percent or higher from 1996-1998 in Latvia, Hungary, Croatia, Estonia, and Poland. Comparable growth has occurred more recently in Lithuania and Slovakia in 1998. More modest productivity growth has occurred in the Czech Republic and Slovenia. In most of these countries, rapid output growth in 1997 and 1998 has been driving the productivity gains, rather than decreases in employment (which explained much of the earlier productivity gains).

In contrast, productivity in industry has recently been declining in Bulgaria and Romania as the fall in industrial output has exceeded labor shedding. Productivity growth in Russia has been relatively recent and modest. From 1995-1997, it grew by less than three percent. Labor productivity in industry in Russia in 1997 was only two-thirds the 1990 level.

How and to what extent these economies integrate into the world economy play significantly into the type of the transition path and its sustainability. *Tables 12 and 13* highlight some key aspects of this integration: export growth and openness to trade; current account balances; institutional integration; foreign direct investment; and external

debt. In general, these indicators reveal a significant impact on the region from the global (and Russian) financial crisis, albeit one that varies widely across the countries.

Table 12 looks primarily at trade and current account balances. The gains from trade can be substantial, and range from the tangible (of increasing an economy's quantity and quality of available goods, including capital goods) to the intangible (of providing incentives and a constituency to maintain the market-based reforms which also serve as pre-requisites to institutional integration with the industrial market economies).

There is also a downside to integrating into the world economy through trade. When one or more countries incur economic difficulties, these troubles spill over to trading partners. This is a primary story in the Russian crisis. As shown in *Appendix II*, trade links to Russia are significant for virtually all the countries of the former Soviet Union. Thirty percent of NIS exports in 1997 went to Russia; almost fifteen percent of 1997 exports from the three Baltic countries went to Russia.

These strong ties become evident when one looks at export growth and current account trends. Overall **export growth** for the entire transition region slowed considerably from the 1995-1997 average of twelve percent (from *Monitoring Country Progress*, October 1998) to an average of two percent from 1996-1998. This is largely because exports contracted by seven percent in the region as a whole in 1998. Eleven of the twelve NIS countries witnessed a shrinking export sector in 1998. Eight NIS countries, including Russia, saw exports fall in 1998 by more than ten percent.

Exports in the Northern Tier CEE countries, in contrast, grew by eleven percent in 1996-1998, and slightly higher in 1998. Exports grew by more than ten percent in 1998 in six of the eight Northern Tier CEE countries, all but Lithuania and Slovenia. Except for Bosnia-Herzegovina, 1996-1998 average export growth rates in the Southern Tier CEE countries were flat at best, ranging from a three percent growth in Albania and Macedonia to a seven percent contraction in Bulgaria.

The Northern Tier CEE countries are the most outward-oriented; their exports and imports on average equal forty percent of GDP. Such **openness to trade**, to some extent, is a reflection of the competitiveness of an economy (though smaller economies also tend to be more open out of necessity). The Northern Tier average on this score is comparable to the average of the advanced economies (thirty-nine percent), though falls short of the EU average of fifty-one percent. The NIS countries and the southern Tier CEE countries generally have considerably smaller trade sectors than do the Northern Tier CEE countries; closer to twenty-five percent of GDP on average.

As alluded to above, the merits of outward-orientation hinge in no small part on the direction and composition of trade. The differences between the sub-regions in these matters are striking.¹¹ By 1996, almost sixty percent of CEE exports went to the EU. In contrast, Russia sells thirty-three percent of its exports to Western Europe, and for the rest

¹¹ *Appendix II* of *Monitoring Country Progress* (October 1998) further highlights these trends.

of the NIS, it is closer to only fifteen percent. Conversely, almost sixty percent of total exports from the NIS (less Russia) in 1996 stayed within the former Soviet Union. This is, nevertheless, down considerably from the proportion (close to ninety percent) in 1990. For CEE, less than fifteen percent of total exports are sold to the former Soviet Union; in 1990, it was thirty percent.

Export structures vary widely as well. In 1995, more than forty percent of CEE exports were manufactures. This compares to nine percent in the NIS. Forty-three percent of NIS exports in 1995 were raw materials and fuels; for CEE, these exports were less than fifteen percent of the total.

Most transition countries continue to incur high **current account deficits** (*Table 12*). Many such deficits, particularly those of NIS countries, have deteriorated due to the collapse of exports to Russia. Falling commodity prices and higher financing costs for imports, both spillovers from the global financial crisis more broadly, have also adversely affected the trade balances of many of the transition countries.

Thirteen countries had a current account deficit equal to or greater than five percent of GDP on average from 1994-1996. This increased to eighteen countries in 1998. Ten countries had a deficit greater than ten percent of GDP in 1998. This included Lithuania, Latvia, Slovakia, Bosnia-Herzegovina, and six NIS countries (Turkmenistan, Moldova, Georgia, Azerbaijan, Armenia, and Kyrgyzstan). On average, the Southern Tier CEE countries have been incurring the highest current account deficits (close to seven to eight percent of GDP since 1994). But the subregional averages for the Northern Tier CEE countries and the NIS countries are too high, as well.

To some extent, as the economies climb out of the “transition trough” and incur robust economic growth, current account deficits can be expected, and may reflect positive developments. Such deficits may be temporary if much of the imports are capital goods that in turn spur increases in competitiveness and exports. This is likely happening in some CEE countries, in the Northern Tier CEE in particular. Still, the extent to which the current account balances have deteriorated in the Northern Tier CEE countries is striking; from a deficit of one percent of GDP in 1994-1996 to over five percent in 1998.¹²

An important means to institutionalize global integration, and hence to lock-in the gains from reform, is through memberships and/or **participation in international organizations**. For our purposes, this includes membership or participation towards membership in the OECD, the World Trade Organization, NATO, and the European Union. As shown in *Table 12*, institutional integration, as so defined, is taking place almost exclusively among the CEE countries, and primarily in the Northern Tier. The Czech Republic, Hungary, and Poland have recently joined NATO. In addition, these

¹² It is also important to recognize, however, that large current account deficits are less burdensome if, as is the case in many Northern Tier CEE countries, they can be financed in large part by significant FDI inflows. Most NIS countries don't have this option, which means that adjustment through contraction of the economy (and with it the demand for imports) and/or currency devaluation may become more necessary.

three countries plus Slovenia and Estonia have been invited to participate in the next round of negotiations towards EU membership. Kyrgyzstan and Latvia are the most recent members in the region in the World Trade Organization. Of the nine WTO members in the transition region, Kyrgyzstan is the first from the NIS.

Foreign direct investment (FDI) is key to the transition (*Table 13*). It helps meet the substantial fixed investment needs of the region that arise from obsolete fixed capital stocks and inadequate infrastructure. It does so without adding to the external debt burden. In the context of highly volatile short-term capital flows, it is a stabilizing influence. And, it brings with it some very important externalities, including access to advanced technology and export markets, and exposure to advanced management and marketing techniques. Moreover, FDI not only follows reforms, it also contributes towards catalyzing and sustaining more reforms.

FDI flows increased significantly in 1998 in the CEE countries and, except for Russia, were relatively constant in the NIS. FDI per capita in Russia in 1998 fell to less than a third of the FDI in 1997. These trends, particularly in the CEE countries, were quite remarkable in the context of the global financial crisis and help underscore the stability of FDI relative to short-term capital. The trends also shed light on a more general trend of growing differentiation of emerging markets by foreign investors. In fact, the CEE countries, Northern Tier in particular, have proved to be among the most resilient emerging markets in 1998.

The greatest FDI inflows in 1998 on a per capita basis occurred in Estonia, Lithuania, the Czech Republic, Hungary, Poland, Azerbaijan, and Croatia. All of these countries, but Azerbaijan, experienced an increase in FDI from 1997 levels.

Almost fifty percent all FDI inflows since 1989 occurred in 1997 and 1998. Most FDI continues to go to the advanced reformers, and is largely tied to privatization. Hungary has attracted far and away the greatest cumulative FDI per capita of all the transition countries since 1989. However, there continues to be growing diversification in the destination of FDI flows. The relatively small amount of FDI that has flowed to the NIS has largely been in response to opportunities to exploit energy resources, in Turkmenistan, Azerbaijan, and Kazakhstan, in particular.

The importance of a sustainable **external debt** position has increased in the current global economic context (*Table 13*). Overall, external debt as a percent of exports has been increasing in a large majority of transition countries in recent years. In fact, from 1995-1998, it increased in twenty-one countries. Only in three Northern Tier CEE countries (Hungary, Poland, and Latvia) and in Bosnia-Herzegovina (where it is still much too high), is the debt to export ratio lower today than in 1995. It's important to recognize that an important part of this trend is slow growing or even contracting exports.

The average NIS debt as a percent of exports (at 161 percent) is comparable to the average for the developing countries. It is even slightly higher in the Southern Tier CEE countries on average (172 percent). The World Bank classifies countries as “moderately

indebted” if this percent exceeds 132 percent and “severely indebted” if external debt is more than 220 percent of exports. Two transition countries were severely indebted and four were moderately indebted in 1996. By 1998, this had increased to six countries that were severely indebted (Albania, Georgia, Armenia, Bosnia-Herzegovina, Bulgaria, and Turkmenistan) and six that were moderately indebted.

Nevertheless, servicing the debt has not yet been too onerous for most countries. Hungary has the highest debt service as a proportion of exports (forty-four percent in 1997). Georgia likely has the next highest debt service ratio at twenty-two percent. For the transition region as a whole, it is closer to eleven percent, and well below the average debt service ratio for the developing countries.

Table 7. Growth in Real GDP (%)

Country	1992	1993	1994	1995	1996	1997	1998	1999 proj.*	1996-1998 average
Bosnia-Herzegovina	...	...	...	21.0	69.0	30.0	18.0	9.5	39.0
Georgia	-44.8	-25.4	-11.4	2.4	10.5	11.0	2.9	2.0	8.1
Belarus	-9.6	-7.6	-12.6	-10.4	2.8	10.4	8.0	-2.0	7.1
Estonia	-14.2	-9.0	-2.0	4.3	4.0	11.4	4.0	3.0	6.5
Kyrgyzstan	-19.0	-16.0	-20.0	-5.4	7.1	10.4	1.8	2.0	6.4
Poland	2.6	3.8	5.2	7.0	6.1	6.9	4.8	3.0	5.9
Slovakia	-6.5	-3.7	4.9	6.9	6.6	6.5	4.4	1.0	5.8
Azerbaijan	-22.6	-23.1	-19.7	-11.8	1.3	5.8	10.1	5.0	5.7
Armenia	-52.6	-14.8	5.4	6.9	5.8	3.1	7.2	4.0	5.4
Croatia	-11.7	-8.0	5.9	6.8	6.0	6.5	2.5	-1.5	5.0
Lithuania	-21.3	-16.2	-9.8	3.3	4.7	6.1	4.0	2.5	4.9
Latvia	-34.9	-14.9	0.6	-0.8	3.3	6.5	4.0	2.6	4.6
Slovenia	-5.5	2.8	5.3	4.1	3.3	3.8	4.0	2.3	3.7
Hungary	-3.1	-0.6	2.9	1.5	1.3	4.4	5.0	3.7	3.6
Albania	-7.2	9.6	9.4	8.9	9.1	-7.0	8.0	5.0	3.4
Uzbekistan	-11.1	-2.3	-4.2	-0.9	1.6	2.4	2.0	1.0	2.0
FYR Macedonia	-21.1	-9.1	-1.8	-1.2	0.8	1.5	3.0	-4.5	1.8
Czech Republic	-3.3	0.6	3.2	6.4	3.9	1.0	-2.7	0.0	0.7
Tajikistan	-29.0	-11.0	-18.9	-12.5	-4.4	1.7	4.0	3.0	0.4
Kazakhstan	-2.9	-9.2	-12.6	-8.2	0.5	2.0	-2.5	-3.0	0.0
Russia	-14.5	-8.7	-12.7	-4.1	-3.5	0.8	-4.6	-5.0	-2.4
Romania	-8.8	1.5	3.9	7.1	4.1	-6.6	-7.3	-3.5	-3.3
Ukraine	-13.7	-14.2	-23.0	-12.2	-10.0	-3.2	-1.7	-3.5	-5.0
Bulgaria	-7.3	-1.5	1.8	2.1	-10.9	-6.9	2.5	0.0	-5.1
Moldova	-29.1	-1.2	-31.2	-3.0	-8.0	1.3	-8.6	-5.0	-5.1
Turkmenistan	-5.3	-10.0	-18.8	-8.2	-8.0	-26.1	4.2	20.0	-10.0
Regional Averages	1992	1993	1994	1995	1996	1997	1998	1999 proj.*	1996-1998 average
CEE & NIS	-12.1	-7.1	-9.2	-2.4	-0.7	1.3	-0.8	-1.7	0.0
Northern Tier CEE	-2.6	0.3	3.6	5.6	4.9	5.7	3.7	2.5	4.7
Southern Tier CEE	-9.3	-0.1	3.9	6.9	6.5	-2.2	-0.9	-1.1	1.1
NIS	-14.9	-10.0	-14.4	-5.9	-3.3	0.8	-1.9	-2.8	-1.5
European Union	1.1	-0.5	3.0	2.4	1.8	2.7	2.8	1.8	2.4
Advanced Countries	1.9	1.2	3.2	2.6	3.2	3.2	2.2	2.0	2.9
Developing Countries	6.7	6.5	6.8	6.1	6.5	5.7	3.3	3.1	5.2

Benchmarks

(a) 3 years positive economic growth, (b) 3 year average growth rate of 2% or more

* EBRD estimates were made prior to the escalation of the crisis in Kosovo. Drawing from most recent World Bank and IMF estimates, 1999 projections were revised down for the following countries: Bosnia-Herzegovina (from 16% to 9.5%), Bulgaria (2.0% to 0.0%), Croatia (1.0% to -1.5%), FYR Macedonia (4.0% to -4.5%), Hungary (from 4.2% to 3.7%), Romania (-3.0% to -3.5%), and Slovenia (3.8% to 2.3%). The incremental effects from the war on economic growth in Albania are estimated to be zero on balance.

EBRD, *Transition Report Update 1999* (April 1999, and previous editions); IMF, *World Economic Outlook* (May 1999).

Table 8. Inflation

	1994	1995	1996	1997	1998	1999 proj.	1997-98	1996-98
Bosnia-Herzegovina	780	-4	-25	14	5	5	10	-2
Azerbaijan	1,788	85	7	0	-8	3	-4	0
FYR Macedonia	55	9	-1	3	-2	2	0	0
Croatia	-3	4	3	4	5	4	5	4
Slovakia	12	7	5	6	6	9	6	6
Latvia	26	23	13	7	3	4	5	8
Lithuania	45	36	13	9	2	4	5	8
Slovenia	20	9	9	9	7	7	8	8
Czech Republic	10	8	9	10	7	6	8	8
Armenia	1,885	32	6	22	-1	13	10	9
Georgia	6,474	57	14	7	11	...	9	11
Estonia	42	29	15	12	7	6	10	11
Poland	29	22	19	13	9	...	11	13
Kazakhstan	1,160	60	29	11	2	10	7	14
Moldova	116	24	15	11	18	15	15	15
Hungary	21	28	20	18	10	8	14	16
Kyrgyzstan	96	32	35	15	18	15	17	23
Albania	16	6	17	42	9	8	25	23
Ukraine	401	182	40	10	20	18	15	23
Russia	204	129	22	11	85	90	48	39
Uzbekistan	1,281	117	64	50	40	27	45	51
Tajikistan	1	2,133	41	164	7	10	85	70
Romania	62	28	57	151	40	35	96	83
Belarus	1,960	244	39	63	182	246	122	95
Turkmenistan	1,328	1,262	446	22	28	33	25	165
Bulgaria	122	33	311	579	1	6	290	297
REGIONAL AVERAGES	1994	1995	1996	1997	1998	1999 proj.	1997-98	1996-98
CEE & NIS	466.9	139.8	37.6	36.7	45.2	53.2	41.0	39.8
Northern Tier CEE	24.9	20.1	15.6	12.4	7.8	6.8	10.1	11.9
Southern Tier CEE	115.1	21.4	87.5	191.3	22.1	20.6	106.7	100.3
NIS	636.5	189.3	35.6	19.1	58.6	64.3	38.8	37.7
European Union	3.0	2.9	2.5	1.9	1.5	1.3	1.7	2.0
Advanced Countries	2.6	2.5	2.4	2.1	1.6	1.4	1.9	2.0
Developing Countries	51.8	22.2	14.3	9.4	10.4	8.8	9.9	11.4
Benchmarks							< 10.0	< 15.0

Retail/consumer prices, end-year if available. Data for Bosnia-Herzegovina represent the annual average inflation rates for the DM-based Federation of Bosnia and Herzegovina economy.

EBRD, *Transition Report Update 1999* (April 1999); IMF, *World Economic Outlook* (May 1999).

Table 9. Fiscal Balance as Percent of GDP

	1992	1993	1994	1995	1996	1997	1998	1999 proj.*	1996-1998 average
Estonia	-0.3	-0.7	1.3	-1.3	-1.5	1.9	-0.3	0.0	0.0
Latvia	-0.8	0.6	-4.0	-3.3	-1.4	1.3	0.1	-2.9	0.0
Bosnia-Herzegovina	...	...	-17.0	0.0	-4.0	-2.0	-3.0	-4.8	0.0
Croatia	-3.9	-0.8	1.6	-0.9	-0.4	-1.3	0.5	-2.9	-0.4
FYR Macedonia	-9.6	-13.8	-2.9	-1.2	-0.5	-0.4	-1.7	-5.3	-0.9
Belarus	0.0	-1.9	-2.5	-1.9	-1.6	-0.7	-1.0	-2.0	-1.1
Slovenia	0.2	0.1	-0.3	-0.5	-0.2	-1.7	-1.4	-1.2	-1.1
Turkmenistan	13.2	-0.5	-1.4	-1.6	-0.2	0.0	-4.0	-4.0	-1.4
Czech Republic	-3.1	0.5	-1.2	-1.8	-1.2	-2.1	-2.7	-3.5	-2.0
Azerbaijan	2.8	-15.3	-12.1	-4.9	-2.8	-1.7	-4.1	-4.0	-2.9
Poland	-6.7	-3.1	-3.1	-2.8	-3.3	-3.1	-3.0	-3.0	-3.1
Slovakia	-11.9	-7.0	-1.3	0.2	-1.9	-3.8	-5.6	-3.2	-3.8
Ukraine	-25.4	-16.2	-9.1	-4.4	-3.2	-5.6	-2.5	-2.0	-3.8
Lithuania	0.5	-3.3	-5.5	-4.5	-4.5	-1.8	-6.0	-2.5	-4.1
Tajikistan	-28.4	-23.6	-10.2	-11.2	-5.8	-3.3	-3.2	-3.8	-4.1
Georgia	-25.4	-26.2	-7.4	-4.5	-4.4	-3.8	-4.4	-4.1	-4.2
Hungary	-7.6	-8.9	-8.6	-6.2	-3.1	-4.9	-4.6	-4.4	-4.2
Romania	-4.6	-0.4	-1.9	-2.6	-4.0	-3.6	-5.5	-3.9	-4.4
Uzbekistan	-18.4	-10.4	-6.1	-4.1	-7.3	-2.3	-3.8	...	-4.5
Bulgaria	-5.2	-10.9	-5.8	-6.4	-13.4	-2.6	1.0	-3.8	-5.0
Russia	-4.1	-7.4	-9.0	-5.7	-8.3	-5.0	-3.6	0.7	-5.6
Kazakhstan	-7.3	-4.1	-7.5	-2.7	-4.7	-6.8	-8.0	-7.0	-6.5
Armenia	-13.9	-54.7	-10.5	-11.0	-9.3	-5.9	-5.2	-5.5	-6.8
Moldova	-26.2	-7.4	-8.7	-5.7	-6.7	-7.5	-7.5	-4.5	-7.2
Kyrgyzstan	-17.4	-14.2	-11.6	-17.0	-9.0	-9.4	-9.8	...	-9.4
Albania	-20.3	-14.4	-12.4	-10.3	-12.1	-12.7	-10.7	-16.6	-11.8
REGIONAL AVERAGES	1992	1993	1994	1995	1996	1997	1998	1999 proj.*	1996-1998 average
CEE & NIS	-9.0	-8.4	-7.0	-4.7	-5.7	-4.3	-3.7	-1.9	-4.6
Northern Tier CEE	-5.8	-3.4	-3.5	-2.9	-2.8	-2.9	-3.3	-3.1	-3.0
Southern Tier CEE	-6.2	-4.4	-3.2	-3.7	-6.0	-3.7	-3.7	-4.9	-4.5
NIS	-10.2	-10.3	-8.5	-5.3	-6.5	-4.7	-3.8	-1.0	-5.0
European Union	-5.1	-6.4	-5.7	-5.2	-4.3	-2.3	-2.0	...	-3.9
Advanced Countries	-3.6	-4.1	-3.4	-3.2	-2.4	-1.0	-0.9	-1.3	-2.2
Developing Countries	-3.4	-3.5	-3.2	-3.0	-2.7	-2.6	-3.9	-4.0	-2.8
European Union Target									-3.0
Benchmark									-3.0

* EBRD estimates were made prior to the escalation of the crisis in Kosovo. Drawing from most recent World Bank and IMF estimates, 1999 projections were revised for the following countries: Albania (from -13.0% to -16.6%), Bosnia-Herzegovina (-3.0% to -4.8%), Bulgaria (-2.8% to -3.8%), Croatia (-1.8% to -2.9%), FYR Macedonia (-2.0% to -5.3%), Hungary (-3.9% to -4.4%), Romania (-3.7% to -3.9%), and Slovenia (-1.0% to -1.2%).

Primary sources: EBRD, *Transition Report Update* (April 1999); IMF, *World Economic Outlook* (May 1999).

Table 10. Domestic Investment and Private Sector Share of GDP

Country	Gross Domestic Investment					Private Sector Output	
	1990	1994 % of GDP	1997	1990-1997 % change	1994-1997 % change	1996 % of GDP	mid-year 1998
Hungary	25	22	27	8	23	70	80
Albania	29	14	12	-59	-14	75	75
Czech Republic	29	20	34	17	70	75	75
Slovakia	34	17	35	3	106	70	75
Estonia	30	33	30	0	-9	70	70
Lithuania	34	...	27	-21	...	65	70
Russia	30	27	22	-27	-19	60	70
Poland	26	16	22	-15	38	60	65
Armenia	47	10	9	-81	-10	50	60
Kyrgyzstan	24	...	22	-8	...	50	60
Latvia	40	11	20	-50	82	60	60
Romania	30	27	21	-30	-22	60	60
Croatia	13	14	15	15	7	50	55
Georgia	...	...	7	...	...	50	55
Kazakhstan	43	24	16	-63	-33	40	55
Slovenia	17	21	24	41	14	45	55
Ukraine	28	...	20	-29	...	40	55
Bulgaria	26	21	12	-54	-43	45	50
FYR Macedonia	32	18	19	-41	6	...	50
Azerbaijan	28	23	28	0	22	25	45
Moldova	...	...	24	...	...	40	45
Uzbekistan	32	23	19	-41	-17	40	45
Tajikistan	23	...	17	-26	...	20	30
Turkmenistan	40	...	...	...	...	20	25
Belarus	27	...	26	-4	...	15	20
REGIONAL AVERAGES	1990	1994 % of GDP	1997	1990-1997 % change	1994-1997 % change	1996 % of GDP	mid-year 1998
CEE & NIS	30	24	21	-28	-9	52	61
Northern Tier CEE	28	18	26	-7	44	64	69
Southern Tier CEE	27	23	18	-35	-23	57	58
NIS	31	26	21	-32	-19	49	59
Advanced Economies			21			70-85	
Developing Countries			25				
Sub-Saharan Africa			18				
East Asia/Pacific			36				
Benchmarks	GDI/GNP > 25%			no decline		more than 70%	

Source: EBRD, *Transition Report 1998* (November 1998); World Bank, *World Development Indicators 1999* (March 1999 and previous editions).

Table 11. Labor Productivity

Labor Productivity in Industry/Manufacturing (% change)										1996-98 ¹ average	1998/1989 ² (%)
Region/Country	1990	1991	1992	1993	1994	1995	1996	1997	1998		
CEE											
Latvia	...	...	...	...	9.5	-1.0	8.6	28.0	1.9	12.8	...
Hungary	0.4	-17.9	10.7	18.5	7.3	10.9	9.0	14.3	13.3	12.2	182
Croatia	-10.0	-14.0	-1.0	-2.0	1.6	5.8	11.4	12.0	9.2	10.9	110
Estonia	...	...	...	...	6.7	0.4	3.7	26.3	2.3	10.8	...
Poland	-21.1	-11.9	17.1	14.5	14.0	7.0	10.0	12.1	6.3	9.5	149
Lithuania	...	...	...	...	-12.1	12.0	8.5	7.6	11.0	9.0	...
Czech Republic	-0.4	-16.6	-7.6	-3.5	4.9	11.1	9.6	11.1	5.6	8.8	111
Slovakia	...	...	7.4	0.6	9.3	5.3	2.5	4.1	11.5	6.0	...
Slovenia	-9.0	-1.0	-1.0	5.0	11.8	8.4	5.7	4.5	5.4	5.2	132
Bulgaria	-10.4	-11.1	0.2	5.5	12.6	7.3	3.4	-3.8	...	2.3	101
Romania	-24.6	-18.5	-12.3	9.0	10.1	20.0	12.1	1.0	-15.9	-0.9	74
Russia	1.0	-5.0	-12.0	-14.2	-17.7	4.8	0.2	3.1	...	2.7	65
Ukraine	0.0	-5.0	-1.0	-1.0	-18.0	...	...	...	...	...	...

¹1995-1997 for Bulgaria and Russia. ²1997/1989 ratio for Bulgaria and Russia

EBRD, *Transition Report Update 1999* (April 1999), and previous editions of the EBRD report.

Table 12. Integration into the World Economy (I)

Country	Export Growth (average annual %)	Export Growth	Openness to Trade (% of PPP GDP)	Current Account Balance (% of GDP)			Institutional Integration
	1996-1998	1998	1997	1994-1996	1997	1998	1999
Czech Republic	7	16	48	-3.5	-6.2	-1.9	(1) (2) (3) (4) (5)
Hungary	22	17	55	-6.2	-2.1	-4.7	(1) (2) (3) (4) (5)
Poland	10	11	27	2.0	-3.1	-4.5	(1) (2) (3) (4) (5)
Slovenia	3	8	76	1.4	0.2	0.0	(2) (4) (5)
Bulgaria	-7	-13	25	-0.5	4.2	-1.2	(2) (4)
Latvia	14	11	45	-2.7	-6.2	-11.2	(2) (4)
Romania	2	-2	20	-4.7	-6.7	-7.9	(2) (4)
Slovakia	8	11	51	-1.4	-10.0	-10.9	(2) (4)
Estonia	17	17	92	-6.9	-12.0	-8.6	(4) (5)
Kyrgyzstan	11	-16	12	-17.0	-7.9	-15.0	(2)
Lithuania	16	1	57	-7.2	-10.2	-13.5	(4)
Albania	3	23	11	-10.2	-12.2	-8.1	
Armenia	-6	-4	12	-33.3	-27.8	-27.8	
Azerbaijan	1	-15	13	-15.9	-23.7	-31.1	
Belarus	15	-3	32	-5.8	-5.9	-6.8	
Croatia	0	8	54	-2.0	-12.6	-7.1	
FYR Macedonia	3	10	45	-6.2	-8.3	-9.2	
Georgia	4	-14	11	-12.2	-6.8	-12.2	
Kazakhstan	6	-12	19	-4.8	-4.0	-6.5	
Moldova	-1	-15	32	-9.4	-13.5	-19.7	
Russia	-3	-17	21	2.7	0.7	0.7	
Tajikistan	-5	-4	22	-31.6	-5.4	-7.3	
Turkmenistan	-29	-13	32	2.3	-32.4	-52.7	
Ukraine	-1	-12	39	-3.1	-2.6	-1.4	
Uzbekistan	2	1	13	-1.8	-4.1	-3.7	
Bosnia-Herzegovina	78	42	...	-39.3	-45.0	-29.0	
CEE & NIS	2	-7	27	-2.2	-3.8	-4.5	
Northern Tier CEE	11	12	40	-0.9	-4.4	-5.3	
Southern Tier CEE	6	3	25	-6.6	-8.6	-8.2	
NIS	-1	-13	24	-1.9	-2.9	-3.7	
European Union	6.7	5.2	51	1.2	1.7	1.0	
Advanced Economies	6.6	3.2	39	1.2	1.4	1.6	
Benchmarks	(a) 3 year average export growth > 5%						
	(b) 3 year average current account balance no worse than -5%						

Note: Openness to trade is defined as exports plus imports expressed as a percentage of purchasing power parity GDP. Institutional integration refers to membership or participation in (1) OECD, (2) WTO, (3) NATO; (4) Europe Agreements with EU; (5) invited to participate in the next round of negotiations toward EU membership. Current account figures for Bosnia-Herzegovina exclude official transfers.

Source: EBRD, *Transition Report Update 1999* (April 1999); IMF, *World Economic Outlook* (May 1999); and World Bank, *World Development Indicators 1999* (March 1999).

Table 13. Integration into the World Economy (II)

Country	<u>Foreign Direct Investment</u> (per capita)			<u>External Debt</u> (% of exports)		
	1989-1998	1997	1998	<u>Debt</u>		<u>Debt Service</u>
				1995	1998	1998
Czech Republic	968	124	243	77	89	15
Hungary	1,652	163	168	247	106	<i>44</i>
Poland	389	79	171	197	149	<i>6</i>
Slovenia	596	148	77	36	54	13
Bulgaria	155	60	44	191	251	<i>16</i>
Latvia	634	206	80	105	92	15
Romania	200	54	90	84	109	<i>20</i>
Slovakia	236	15	46	66	111	12
Estonia	947	90	390	17	123	5
Kyrgyzstan	72	18	11	143	<i>148</i>	<i>8</i>
Lithuania	422	89	257	31	83	12
Albania	132	13	14	333	437	<i>6</i>
Armenia	63	14	38	137	359	12
Azerbaijan	415	144	142	62	100	7
Belarus	39	19	11	32	32	2
Croatia	349	41	133	72	176	11
FYR Macedonia	97	14	58	88	98	<i>9</i>
Georgia	89	35	41	338	405	22
Kazakhstan	383	84	86	96	132	...
Moldova	79	15	23	91	173	<i>17</i>
Russia	60	25	7	148	199	13
Tajikistan	17	5	2	97	178	11
Turkmenistan	157	23	23	26	251	...
Ukraine	54	12	14	58	85	20
Uzbekistan	23	7	7	51	76	15
Bosnia-Herzegovina	...	0	...	2,211	338	9
CEE & NIS	201	42	53	123	155	11
Northern Tier CEE	659	99	174	159	124	14
Southern Tier CEE	179	44	78	125	172	17
NIS	86	27	18	114	161	9
Developing Countries				164	161	24
Benchmarks	(a) below the "moderately indebted" threshold (i.e., debt < 132% of exports)					
	(b) debt service less than 20%					

Note: Foreign direct investment figures for 1989-1998 are cumulative. External debt and debt service figures in italics refer to 1997.

Source: EBRD, *Transition Report Update* (April 1999); IMF, *World Economic Outlook* (May 1999).

2. Social Conditions

Ultimately, the sustainability of the transition hinges on the well being of the individual. Humanitarian considerations are important. However, equally if not more compelling are the links between living standards, popular expectations, and the level of public support for economic and political reforms--reforms which have coincided with, if not contributed to, both a dramatic initial drop in overall income and significant increases in income inequalities and poverty in most cases. The links between macroeconomic performance and social conditions may grow in importance as well, particularly in a setting of sustained deterioration of social conditions. Productivity is eroded or stifled in such a setting.

Tables 14 through 22 and Figures 2 through 7 highlight social conditions. **Unemployment** needs to be a concern. As shown in *Table 14* and *Figure 2*, it is high among most of the CEE countries, and is approaching those high levels in the NIS countries on average.

Significant subregional differences still remain, however. Unemployment in the Northern Tier CEE countries has been falling steadily on average since 1993. In 1997, it fell below ten percent in the subregion and today stands at roughly 9.6 percent on average. It has not been this low since 1991.¹³ The biggest decreases in unemployment in 1998 in the Northern Tier occurred in Hungary (now less than eight percent) and Latvia (now 9.2 percent). Unemployment in the Czech Republic continues to increase; it has been doing so steadily since 1995, when it was far and away the lowest of all the CEE countries. Unemployment is now 7.5 percent in the Czech Republic, more than Lithuania's 6.4 percent, and close to the rate in Hungary. The unemployment rate in Slovenia remains the highest of the Northern Tier CEE countries, and it increased slightly in 1998 to 14.5 percent. Unemployment remains too high in Slovakia as well, where it also increased in 1998, to 11.9 percent.

Some of the highest official unemployment rates of the transition economies are found in the Southern Tier CEE. The subregional unemployment rate in 1998, in fact, was close to twelve percent. It would have likely been higher if 1998 figures were available for Macedonia and Albania. On the basis of 1997 estimates, the official rate is highest in Macedonia where more than one in three persons are unemployed. Unemployment increased in Romania in 1998 (to 10.3 percent) and slightly in Croatia (to 17.6 percent). In contrast, Bulgaria's unemployment rate declined to twelve percent in 1998, roughly back to where it was in 1995-1996.

¹³ This Northern Tier CEE unemployment figure of 9.6% is lower than the cited EU unemployment figure of 10.2%. However, this comparison needs a caveat. Most (if not all?) of the published unemployment figures for the CEE countries are calculated on the basis of registered unemployed, whereas most (if not all?) Western European countries use surveys to calculate unemployment. Registered unemployment rates tend to underestimate true unemployment rates, particularly in the transition countries. They are based on the number of those who are unemployed who come forth to declare their status, usually to claim unemployment benefits. In the transition countries, there are not always sufficient benefits and/or incentives to come forth.

The official unemployment figures in the NIS are generally lower than in CEE, though they continue to increase in most countries for which data are available. Lower unemployment rates in the NIS may reflect a combination of phenomena. One may be simply poorer data. Another part to it, however, is probably due to a continuing differentiation in how labor markets are adjusting between CEE and the NIS. In particular, underemployment (in the form of fewer work hours, involuntary leave and wage arrears) in the NIS may to some extent continue to exist in lieu of greater open unemployment. Similarly, the degree of open unemployment currently experienced in CEE may be a reflection of what is to come in the NIS--that is, if the NIS countries succeed in moving forward in the transition reforms. At any rate, the subregional averages, as depicted in *Figure 2*, certainly suggest convergence.

Official unemployment is highest in the NIS in Azerbaijan (19.3 percent in 1997), Georgia (fourteen percent), Russia (12.4 percent), and Armenia (9.9 percent). Most recent data show it to be less than five percent for the rest. Moldova's unemployment rate (of 1.6 percent in 1997) may be the most anomalous given it is the NIS economic reform leader, followed closely by Georgia, Armenia, and Russia.

A critical consideration is the extent to which these unemployment figures represent the same people from year to year. In other words, how long are people typically unemployed? With official safety nets disappearing, we know that unemployment is a crucial determinant towards poverty. Monitoring **long-term unemployment** is hence important, and *Table 15* addresses this aspect in part for many of the CEE countries. Many data gaps exist and we can only sketch a rough picture. Forty-four percent of the unemployed in 1996 in the eight CEE countries for which data are available was unemployed for more than one year. This represents a large increase from 1992 when one in four of the unemployed was long-term unemployed, though a slight decrease from 1995. It is interesting to note that the proportion of long-term unemployment in some countries of Western Europe is also greater today than in the early 1990s. This trend, in other words, is not solely a transition phenomenon.

Long-term unemployment may be particularly troublesome for Macedonia and Albania. In 1996, eighty-one percent of those unemployed in Macedonia were unemployed for more than one year. With very high total unemployment, this translates into very high long-term unemployment: twenty-six percent. More recent data are needed to better assess the situation in Albania. In 1993, almost nineteen percent of Albania's labor force (or sixty-five percent of all those unemployed) had been unemployed for more than one year.

Tables 16 through 19 and *Figures 3 and 4* shed light on living standards through indicators of income. From *Table 16*, we see that **average income** in the transition economies remains significantly below that in the advanced economies. In purchasing power parity (PPP) terms, average income in the transition region is roughly one-fifth the EU average. Furthermore, average income varies widely among the transition countries. Per capita income in Slovenia and the Czech Republic exceeds \$10,000 in PPP terms; it is closer to \$1,000 in Tajikistan and is not much higher in a handful of other countries,

including Moldova (\$1,330), Turkmenistan (\$1,470), and Azerbaijan (\$1,670). In general, average income of the Northern Tier countries is much greater than per capita income of the rest; more than twice the average income in the NIS, and just short of twice the average income in the Southern Tier CEE.

What may be more important for our purposes is how the income levels have changed during the transition, and how it has been distributed within countries. Other things equal, the greater the income disparities and collapse in incomes, the more pronounced are the hardships and the greater is the likelihood of “reform fatigue.”

In this regard, it is significant to note (as shown in *Table 16*) that only a handful of countries regained pre-transition income (Poland, Slovenia, and Slovakia) or came close to regaining it (the Czech Republic and Hungary) by the end of 1998. Of the Northern Tier CEE countries, Latvia and Lithuania still have incomes considerably below pre-transition levels. Average income in Latvia in 1998 was only fifty-eight percent of 1989 income, a level more characteristic of the NIS countries than Northern Tier CEE.

The 1998 average income in the Southern Tier CEE is roughly only three-fourths 1989 income. The NIS lag even more; 1998 income in the NIS on average is fifty-four percent the income level of 1989. The NIS range is particularly large: current official income in Uzbekistan is close to ninety percent of 1989 income; in Moldova and Georgia, it is only a third.

We can fill in the picture further with **income distribution** data. In general, while income inequality has increased dramatically for virtually all the transition economies since communism's demise, the degree of inequality for most transition countries is roughly comparable to that found in the advanced industrialized economies. These were highly egalitarian societies prior to the collapse of communism.

Of the transition subregions, income inequality was the greatest in the NIS at the outset of the transition and yet has increased the most in the NIS during the transition (by almost fifty percent). This compares to a roughly thirty-three percent increase in income inequality in CEE from 1989 to 1996 and to a two percent increase in the EU over a comparable period of time.

The distribution of income is the most unequal in Russia, followed by Kyrgyzstan and Ukraine. Income inequality in these countries compares to that found in the most unequal economies worldwide, that is, those in Latin American and in Sub-Sahara Africa.

Among the transition economies, income looks to be most equally distributed in parts of the pre-transition Yugoslavia (Macedonia and Croatia, in particular) and in the former Czechoslovakia.

An additional important part of the income picture is the unofficial economy. Income from the unofficial economy serves to cushion official income losses. In fact, according to Johnson, Kaufmann, and Shleifer (1997), many of those countries that have

experienced a particularly large decrease in official economic activity have also seen relatively large increases in unofficial economic activity.¹⁴ According to their estimates, the unofficial economy is significant in all seventeen transition countries included in the sample. However, the variation across the countries is also significant. In the NIS, the unofficial economy was almost forty percent of overall official economic activity in 1995; in CEE, it was closer to twenty percent.

The two regions differ substantially in trends over time in the unofficial economy as well. The growth of the unofficial economy has likely peaked for many of the CEE countries, particularly the Northern Tier countries (perhaps except Latvia). In fact, from 1989-1995, the growth of the unofficial economy in CEE has been negligible. In contrast, the unofficial economy on average in the NIS has more than tripled from 1989 to 1995 and is likely still growing in most of the NIS.

Poverty has increased substantially in the transition region as shown in *Table 17*. According to these estimates for 1993-1995, four out of every ten persons in the transition region are poor (that is, earn less than four dollars a day). However, this average masks very wide variation, by country and by groups within countries. Poverty remains negligible in Slovenia, the Czech Republic, and Slovakia. In contrast, at least seven transition economies, all NIS, have poverty rates equal to or greater than fifty percent: Tajikistan, Kyrgyzstan, Moldova, Ukraine, Kazakhstan, Turkmenistan, and Azerbaijan. Poverty in Russia (forty-four percent in 1995) may not be much lower. In fact, on average, one of every two persons in the NIS was poor in 1993-1995. In the Northern Tier CEE countries, it is closer to one of every ten persons, and in the Southern Tier, one out of every four.

Table 17 also reveals that a disproportionate burden from poverty is placed on different segments of society. The poverty estimates for children and the elderly cannot be directly compared with the countrywide estimates since the methods to calculate are different. A comparison between poverty among children with that of the elderly and how those rates have changed since 1989, however, is very revealing.

In general, the data suggest that poverty is much greater among children than it is among the elderly. This is the case in six of the eight countries for which data exist for 1992-1995. By this measure, poverty among Russian children increased from forty percent to over sixty percent since roughly 1990; from two percent to over forty percent in Bulgaria; nine percent to thirty-five percent in Romania; eight percent to twenty percent in Poland.

Poverty rates for the elderly on average in this limited sample are one-half that of children. Among the Northern Tier countries, poverty among the elderly is low and may actually be decreasing: four percent in 1989-1992 to three percent in 1992-1995. It may

14 S. Johnson, D. Kaufmann, and A. Shleifer, "Politics and Entrepreneurship in Transition Economies," *Working Paper Series*, No. 57, The William Davidson Institute, University of Michigan (1997). *Appendix II of Monitoring Country Progress* (January 1998) summarizes the study.

be that the elderly in some of these countries remain politically strong enough to be able to favorably influence pension rates and eligibility.

Some observers have contended that these poverty data overestimate the hardships. Throughout the NIS, for example, even in the countryside, people by and large continue to get by. Some of this can be explained by unofficial sources of income and subsistence activities that are not captured in the “official” poverty rates cited above. Perhaps it would be more meaningful to refer to “subsistence” rates rather than “poverty” rates.

In any case, more effort is needed to better assess the reliability and the meaning of these figures, and to update the trends. More recent poverty rates may reveal declining poverty in parts of CEE and greater poverty in the NIS. At this juncture, however, we can do little more than surmise. *Table 18* provides a basis of comparison of the most recent poverty estimates (using a comparable poverty line) from leading sources: UNDP, EBRD, and Branko Milanovic from the World Bank. Each source is likely drawing from the others and making appropriate adjustments as it sees fit. By and large, while there are some discrepancies, the general trends hold across the board. Nevertheless, the discrepancies do underscore the relative precariousness of the data.

One reason why the poverty estimates vary widely by country is presumably because much of the poverty is shallow. That is, many of the poor are only marginally so, and a relatively small change in the poverty line, can result in a relatively large change in the poverty rate. *Table 19* and *Figure 3* show poverty gap estimates from the World Bank that do suggest that poverty is relatively shallow in much of the transition region. The poverty gap is the average shortfall below the poverty line, which, in this case, is two dollars a day. The higher is the poverty gap, the deeper is the poverty on average. Based on the data of the ten transition countries of the table, the poverty gap in the transition region (at seven percent) is far below regional averages in the developing world: from twenty-two to twenty four percent in Asia and Latin America to over forty percent in Africa.¹⁵

However, the poverty estimates for the transition countries are dated (1992-1994). More recent estimates of at least some of these countries may very likely reveal higher poverty rates and, perhaps from that, deeper poverty as well. In fact, the poverty rate and poverty gap data of *Table 19* show a fairly close fit between the two data series; countries with higher poverty rates tend to have deeper poverty as well. *Figure 4* shows this more clearly.

Table 20 highlights trends in infant mortality rates and life expectancy. For the large majority of countries, **infant mortality rates** have fallen from 1989 to 1997. The trends in the Northern Tier CEE countries are particularly impressive. The rates were the lowest in the Northern Tier CEE countries at the outset of the transition and have fallen the most there during the transition, by almost one half. Northern Tier infant mortality rates in 1997 (nine deaths per 1,000 live births) are now actually below the OECD average (10

¹⁵ Some poverty rate and gap estimates of transition countries from the World Bank were excluded from this table because they are not consistent with the poverty estimates of *Table 18*.

deaths) and are approaching the EU average (5 deaths). The average rates in the NIS and Southern Tier CEE countries are both eighteen deaths per 1,000 live births; i.e., two times the Northern Tier rates.

Infant mortality rates have increased since 1989 in Latvia, Bulgaria, Belarus, and Ukraine. Infant mortality rates remain particularly high in the Central Asian Republics (thirty deaths per 1,000 live births on average in 1997). In the CEE countries, rates are highest in Albania (twenty-six) and Romania (twenty-two).¹⁶

Life expectancy trends in the three transition subregions are consistent with average income trends. From 1989 to 1997, life expectancy has increased in the Northern Tier (for females and males); it has changed little on balance in the Southern Tier CEE (small decrease among males and a fractional increase among females); and it has fallen significantly in the NIS (particularly among the males). The greatest drops in life expectancy since 1989 have occurred among males in Kazakhstan, Ukraine, Belarus, Russia, and Moldova.¹⁷ One aspect to this trend is oftentimes severe hardships for the surviving widows. Life expectancy in Slovenia (at seventy-one years for males and seventy-nine for females) comes closest to life expectancy in the EU (seventy-four years for males; eighty-one for females). The Czech Republic trails closely behind.

As with physical capital, human capital is important for its direct effect on economic sustainability (*Table 21*). It too, however, can provide indications of trends in living standards. **Secondary school enrollment** has increased from 1990 to 1996 in most of the Northern Tier CEE countries, while decreasing in most other transition countries. Greatest drops have occurred in Albania (by over one half), Tajikistan, Kyrgyzstan, Georgia, Romania, and Azerbaijan. Secondary school enrollment in the Northern Tier CEE (at almost ninety-seven percent) is below the EU average (of one hundred and eight percent). While continuing to drop on average, it is still high in the NIS (eighty-four percent). At seventy-two percent, it is lowest in the Southern Tier CEE countries. In 1996, only thirty-eight percent of school age children in Albania were enrolled in secondary schools, far and away the lowest enrollment of the transition countries.

Table 21 also highlights trends in the UNDP's **Human Development Index** (HDI). The HDI is based on three indicators: longevity, as measured by life expectancy; educational attainment, as measured by a combination of adult literacy (two-thirds weight), and combined primary, secondary and tertiary enrollment ratios (one-third weight); and standard of living, as measured by real GDP per capita (PPP\$). The HDI ranges from zero to one; the higher is the value, presumably the greater is the human development.

The UNDP classifies 174 countries into three categories in the *Human Development Report 1998*: high; medium; and low human development. It is based on 1995 data.

¹⁶ The 1997 infant mortality rate for Albania of 26 deaths was adjusted downward significantly by the World Bank from its previous estimate of 37 deaths for 1996.

¹⁷ Earlier estimates suggest that life expectancy for Russian males has been on the rise in the past couple of years or so

Human development is considered high in five transition countries (Slovenia, Czech Republic, Slovakia, Hungary, and Poland), and medium in the rest.

HDI trends over time may be revealing, though more recent data would be helpful. The large majority of the transition countries saw their global ranking deteriorate from 1993 to 1995, though some of this is attributed to an increase in sample size in the most recent calculations. Perhaps more revealing are the trends in the scores from year to year. All but two CEE countries--Latvia and Croatia--showed an increase in the HDI score between the two times. In contrast, all the NIS saw a decrease in the HDI score.

Finally, *Table 22* sheds some light on environmental developments. Environmental degradation was pervasive under central planning. A focus on maximizing production with little or no regard for environmental consequences and with a strong emphasis on heavy industry and highly energy-intensive methods contributed to much of this. Obviously, environmental degradation affects the quality of life and may have bearing on public support for the transition reforms. However, increasing productivity and efficiency are also important byproducts from more environmentally sound policies.

Integral to this for the CEE countries in particular is membership into the EU, which will require gradual adoption of the EU's environmental regulations. Substantial investments will likely need to accompany the establishment of a viable regulatory regime and appropriate energy prices. A 1993 study of six CEE countries (Bulgaria, the Czech Republic, Hungary, Poland, Romania, and Slovakia) estimated environmental investments of fifteen to twenty percent of GDP to bring them up to EU standards.¹⁸

While we have far to go towards better monitoring the environment in the transition economies, *Table 22* fills in a small part of the picture by addressing in part **environmental efficiency and quality**. More efficient use of natural resources (that is, greater environmental efficiency) should translate into lower pollution, at least on a unit of production basis. Energy and water use intensity seem to be reasonable measures of this efficiency.

For this measure, GDP per unit of energy in 1996 is examined. In 1996, no transition country came close to EU standards of energy efficiency by this score. According to these figures, energy efficiency is almost five times greater in the EU than it is in the Northern Tier CEE countries. Moreover, Northern Tier CEE energy efficiency is slightly greater than that in Southern Tier CEE and roughly two times greater than that in the NIS countries.

Table 22 also shows carbon dioxide emissions (per unit of GDP and per capita), and annual mean concentrations of three common air pollutants—sulphur dioxide, nitrogen dioxide, and total suspended particulates—in parts per million for major cities in eighteen

18 Environmental Resource Management, *Environmental Standards and Legislation in Western and Eastern Europe: Towards Harmonization*, Final Report prepared for EBRD/EU-Phare, December 1993.

transition countries and thirteen Western Europe countries. Such emissions are used as proxies for environmental quality.

Most of these indicators show air pollution much higher in the transition countries than in the EU. This applies in particular to sulphur dioxide emissions, TSP concentrations, and carbon dioxide emissions per GDP. Air pollution tends to be higher in the NIS than in CEE.

Carbon dioxide emissions *per capita* were highest in the NIS in 1992 and lowest in the Southern Tier CEE countries. From 1992-1996, these emissions dropped significantly in the NIS, due largely in all likelihood to significant declines in economic activity. They increased slightly in the Southern Tier CEE countries and decreased slightly in the Northern Tier during this period. Robust economic growth resumed in the CEE in 1994. Perhaps, at least in the case of the some Northern Tier CEE countries, environment standards began to see some improvement in this time.

Finally, carbon dioxide emissions *per unit of GDP* in 1996 among the transition countries were lowest in the Northern Tier CEE countries, and highest in the NIS countries. However, by this measure, few transition countries come close to EU standards on environmental quality. CO₂ emissions per unit of GDP in the Northern Tier CEE countries in 1996 were more than six times higher than that in the EU.

Social conditions and economic performance. There may two broad transition scenarios unfolding. In one set of countries, the reforms are moving forward sufficiently. Economic performance and social conditions are improving, and these developments in turn, are providing additional incentives and support to keep the transition reforms moving ahead further still. This is, in other words, a virtuous circle. In another group of countries, however, we may find a vicious circle. The reforms have lagged or stalled or in some cases have at least temporarily backslided. Economic performance continues to be poor. Social conditions continue to deteriorate. These social conditions in turn begin to contribute toward keeping economic performance down and reform progress stalled.

It is in this context that we begin very briefly to look at the links between social conditions and economic performance in *Figures 5- 7*. These relations and their implications may be further spelled out in the ENI Bureau's forthcoming social sector strategy. Macroeconomic performance (as measured by the cumulative economic growth since 1989) is weighed against a country's Human Development Index score (*Figure 5*), income inequality (*Figure 6*) and poverty (*Figure 7*). In all, there is evidence of a fairly strong link between social conditions and economic performance. In short, better social conditions are associated with better economic results. It is probably fair to conclude that causality runs in both directions. On the one hand, greater economic growth has contributed to improved social conditions. Yet, it also seems true that social conditions make a difference in economic performance terms. More equal societies, with lower poverty, and greater overall human development are more likely to generate sustained economic growth.

Figure 5 shows us that countries with greater human development are those that have also experienced greater economic expansion. Uzbekistan and Albania are the interesting outliers in this regard. *Figure 6* reveals that the economies with the greatest income inequality are also those that have contracted the most since the transition began; the more equal societies have generally been the most robust economically. This trend is at odds with the oft-held contention that greater economic growth necessarily comes at the expense of greater economic inequality.

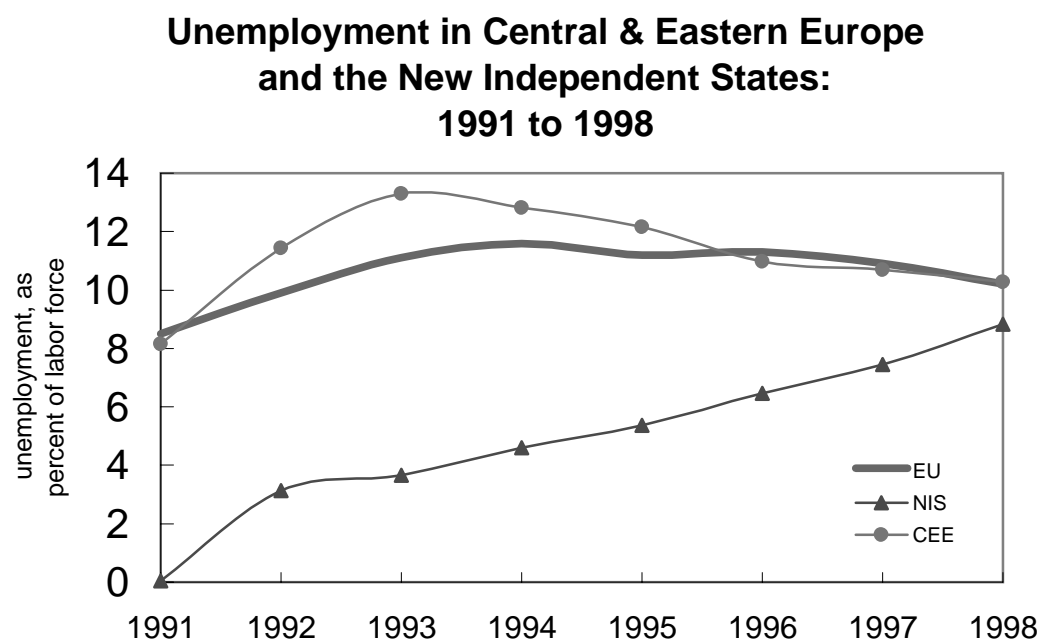
Finally, *Figure 7* shows that higher economic growth coincides with lower poverty when one compares the full sample of transition countries. It is interesting to note, however, that there appears to be three country clusters in this figure. Moreover, the inverse relationship between poverty and growth becomes less evident when one looks at these country clusters in isolation. The cluster of countries with the highest poverty (all NIS) shows little discernable pattern between poverty and growth. The eclectic middle group might even exhibit a positive relationship between poverty and growth. In this group, Uzbekistan has both the highest poverty rate and the best economic growth record; Latvia has contracted the most during the transition and yet has one of the lowest poverty rates of the group.

Table 14. Unemployment Rate

	1991	1992	1993	1994	1995	1996	1997	1998	1996-1998* (average)
CEE:									
Czech Republic	4.1	2.6	3.5	3.2	2.9	3.5	5.2	7.5	5.4
Lithuania	0.3	1.3	4.4	3.8	6.2	7.0	5.9	6.4	6.4
Romania	3.0	8.2	10.4	10.9	9.5	6.6	8.8	10.3	8.6
Hungary	7.4	12.3	12.1	10.4	10.4	10.5	10.4	7.8	9.6
Estonia	...	...	6.5	7.6	9.7	10.0	9.7	9.6	9.8
Poland	11.8	13.6	16.4	16.0	14.9	13.2	10.5	10.4	11.4
Slovakia	...	...	12.2	13.7	13.1	11.1	11.6	11.9	11.5
Bulgaria	11.1	15.3	16.4	12.8	11.1	12.5	13.7	12.0	12.7
Slovenia	8.2	11.5	14.4	14.4	13.9	13.9	14.4	14.5	14.3
Latvia	0.6	3.9	8.7	16.7	18.1	19.4	14.8	9.2	14.5
Albania	8.3	27.9	29.0	19.6	16.9	12.4	...	...	14.7
Croatia	13.2	13.2	14.8	14.5	14.5	16.4	17.5	17.6	17.2
FYR Macedonia	19.2	27.8	28.3	31.4	37.7	31.9	36.0	...	35.2
NIS:									
Uzbekistan	0.0	0.1	0.3	0.4	0.4	0.4	0.4	0.6	0.5
Moldova	...	0.1	0.7	1.1	1.4	1.8	1.6	...	1.6
Ukraine	0.0	0.3	0.4	0.4	0.5	1.1	2.3	3.7	2.4
Tajikistan	...	0.3	1.2	1.7	2.0	2.7	2.9	3.1	2.9
Belarus	0.1	0.5	1.4	2.1	2.7	3.9	2.8	2.3	3.0
Kazakhstan	0.0	0.5	0.6	0.8	1.7	3.6	4.1	...	3.1
Kyrgyzstan	0.0	0.1	0.2	0.7	3.0	4.5	3.2	...	3.6
Armenia	...	1.8	5.3	6.7	6.7	9.2	10.7	9.9	9.9
Georgia	0.2	2.3	6.6	3.6	2.6	12.0	5.1	14.0	10.4
Russia	0.0	4.8	5.3	7.1	8.3	9.2	10.9	12.4	10.8
Azerbaijan	...	15.4	16.0	15.2	17.0	19.4	19.3	...	18.6
Turkmenistan	2.0	...	...	...	3.0	...	...	...	...
CEE & NIS	2.4	5.5	6.5	7.0	7.3	7.8	8.4	9.3	8.5
Northern Tier CEE	8.8	10.6	12.6	12.5	12.0	11.2	9.8	9.6	10.2
Southern Tier CEE	7.0	12.8	14.5	13.4	12.4	10.6	12.4	11.7	12.2
NIS	0.0	3.1	3.6	4.6	5.4	6.5	7.4	8.8	7.4
Advanced Economies	6.6	7.3	7.7	7.6	7.2	7.3	7.0	6.9	7.2
USA	6.8	7.5	6.9	6.1	5.6	5.4	4.9	4.5	5.3
EU	8.5	9.9	11.1	11.6	11.2	11.3	10.9	10.2	11.1
Benchmarks									< 10.0

*1995-7 for Azerbaijan, Kazakhstan, Kyrgyzstan, Macedonia, and Moldova; 1995 to 1996 for Albania.
EBRD, Transition Report Update (April 1999); IMF, World Economic Outlook (May 1999).

Figure 2: Unemployment in CEE and the NIS



Source: EBRD (April 1999); IMF (May 1999).

Table 15. Long-Term Unemployment in CEE

Country	% of Labor Force					% of Total Unemployed					Percent Change: 1992 to 1996
	1992	1993	1994	1995	1996	1992	1993	1994	1995	1996	
Albania	...	18.9	...	...	...	...	65	...	...	...	...
Bulgaria	...	8.7	7.6	7.3	8.0	...	53	59	66	64	21
Croatia	7.7	8.6	8.0	...	...	58	58	55	...	...	-5
Czech Republic	0.4	0.7	0.7	0.9	1.2	14	19	22	31	33	136
Estonia	...	...	...	...	...	...	...	...	...	...	...
Hungary	2.2	4.0	4.3	5.0	5.5	18	33	41	48	52	189
Latvia	...	...	...	...	...	...	...	...	...	...	...
Lithuania	...	...	...	...	...	...	...	...	...	...	...
FYR Macedonia	23.9	24.6	27.6	30.9	25.8	86	87	88	82	81	-6
Poland	3.3	5.9	6.1	6.3	5.0	24	36	38	42	38	58
Romania	1.7	...	4.9	4.5	2.8	21	...	45	47	42	100
Slovakia	...	4.0	5.9	7.1	6.2	...	33	43	54	56	70
Slovenia	5.3	7.9	8.2	7.4	7.4	46	55	57	53	53	15
Northern Tier CEE	2.7	4.7	5.0	5.3	4.7	22	33	37	43	41	87
Southern Tier CEE	4.2	12.2	7.1	6.8	5.5	31	60	52	54	50	59
CEE Overall	3.2	6.3	5.8	5.8	4.9	25	39	42	46	44	76
France	3.7	3.9	4.7	5.3	4.7	36	34	38	40	38	6
Germany	2.5	3.6	4.2	4.5	...	33	36	38	40	...	21
Spain	8.6	11.4	13.6	13.1	...	47	50	56	57	...	21
Sweden	0.4	0.9	1.4	1.2	1.4	8	11	17	16	17	113
UK	...	...	...	...	2.9	30	38	40	38	36	20
Benchmark	Long-term unemployment less than 8% of the labor force										

Note: The long-term unemployed are those who are unemployed for more than one year. Percent change figures cover the period for which data are available.

Source: World Bank, *World Development Indicators 1998* (March 1998); C. Allison and D. Ringold, *Labor Markets in Transition in Central and Eastern Europe: 1989-1995*; World Bank, *Social Challenges of Transition Series* (December 1996); and Bureau of the Census, *Populations at Risk in CEE: Labor Markets*, No. 2, prepared for USAID/ENI/PCS (February 1995).

Table 16. Income and Its Distribution

	1998 Average Income		Distribution of Income				1998/1989 GDP (%)
	US\$	PPP\$	89/90	92/93	95/6	89 - 96 % change	
Poland	4,000	6,820	21	26	29	32	117
Slovenia	9,830	12,360	22	28	30	31	103
Slovakia	3,790	8,210	20	20	...	0	100
Czech Republic	5,350	10,100	20	26	27	30	95
Hungary	4,730	7,320	27	32	...	23	95
Uzbekistan	620	2,500	28	33	...	16	88
Albania	770	2,340	...	...	...	...	86
Croatia	4,480	5,050	25	27	...	8	78
Belarus	1,400	5,210	23	40	...	54	77
Estonia	3,360	5,290	23	40	...	54	76
Romania	1,700	3,960	16	23	30	61	76
Bulgaria	1,700	3,970	21	25	29	32	65
Lithuania	2,830	4,310	26	37	35	30	64
Kazakhstan	1,460	3,440	26	33	...	24	61
Kyrgyzstan	370	2,220	26	45	43	49	61
FYR Macedonia	1,710	3,280	22	27	25	13	58
Latvia	2,520	4,130	24	28	35	37	58
Russia	1,870	4,080	27	46	48	56	55
Azerbaijan	540	1,670	...	...	...	...	44
Turkmenistan	400	1,470	26	36	...	32	44
Armenia	500	2,720	26	37	38	38	41
Tajikistan	200	1,140	...	...	...	...	41
Ukraine	840	2,130	25	36	41	48	37
Georgia	940	2,040	30	40	...	29	33
Moldova	390	1,330	25	44	39	44	32
Bosnia-Herzegovina	970	...	...	...	...	...	...
Yugoslavia	1,270	...	...	...	...	...	...
CEE & NIS	1,950	4,120	25	37	41	43	65
Northern Tier CEE	4,310	7,350	22	27	29	29	104
Southern Tier CEE	1,800	3,920	22	26	31	36	74
NIS	1,360	3,310	26	42	46	48	54
Advanced Economies	25,652	23,200		32		3	
EU	22,441	20,550		28		2	
Benchmark	(a) current year GDP equal to 85% of 1989 GDP						

Note: Average (or per capita) income is measured in US\$ converting through official exchange rates; and through purchasing power parity (PPP) figures. Income distribution is measured by the Gini Coefficient, which ranges from 0 to 100; the higher the figure, the greater the inequality. The percent change in distribution of income in the transition economies is for 1989-1993 when 1995/6 data are not available. For the Advanced Economies and the EU, percent change in income distribution is roughly from 1986 to 1993.

EBRD, *Transition Report Update* (April 1999) and previous editions; World Bank, *World Development Report 1998/99* (November 1998); UNICEF, *Education for All?*, The MONEE Project, #5 (1998); P. Gottschalk and T. Smeeding, "Cross-National Comparisons of Earnings and Income Inequality," *Journal of Economic Literature* 35 (June 1997), pp. 633-687.

Table 17. Poverty

Percent of Population Living in Poverty

Country	<u>Children</u>		<u>Elderly</u>		<u>Overall</u>	
	1989-1992	1992-1995	1989-1992	1992-1995	1987-1988	1993-1995
Czech Republic	0	1	0	1	0	< 1
Slovakia	0	9	0	1	0	< 1
Slovenia	8	...	7	...	0	< 1
Hungary	2	7	1	1	1	2
Poland	8	20	5	3	6	14
Bulgaria	2	43	4	28	2	15
Belarus	...	...	...	...	1	22
Latvia	51	...	15	...	1	22
Romania	9	35	12	19	6	28
Lithuania	...	...	...	...	1	30
Estonia	27	34	38	38	...	37
Uzbekistan	...	...	...	...	24	39
Armenia	...	...	...	...	...	40
Georgia	...	...	...	...	...	40
Russia	40	62	23	34	2	44
Azerbaijan	73	...	65	...	...	50
Turkmenistan	...	...	...	...	12	57
Kazakhstan	...	...	...	...	5	62
Ukraine	...	...	...	...	2	63
Moldova	3	...	3	...	4	66
Kyrgyzstan	...	...	...	...	12	86
Tajikistan	...	...	...	...	...	100
Albania	...	...	...	...	...	...
Croatia	...	...	...	...	...	...
FYR Macedonia	...	...	...	...	...	...
CEE & NIS	28	46	17	24	4	40
Northern Tier CEE	7	14	4	3	3	11
Southern Tier CEE	7	37	10	21	5	24
NIS	41	62	24	34	4	50
UK					1	
Turkey					31	
Malaysia					15	
Brazil					33	

Note: Overall poverty rates for most countries measure the percent of population below poverty line of \$120 per capita per month at 1990 international prices; for Armenia, Azerbaijan, Georgia and Tajikistan the poverty threshold is \$100 per month. For children and elderly, the poverty threshold is roughly 25 percent of the average 1989 wage, and hence is not directly comparable with overall poverty rates.

Source: Branko Milanovic, *Income, Inequality, and Poverty during the Transition from Planned to Market Economy* (World Bank, 1998); UNICEF, *Poverty, Children, and Policy: Responses for a Brighter Future*, Economies in Transition: Regional Monitoring Report 3 (1995); UNDP, *Poverty in Transition?* (July 1998); UNDP, *Human Development Report 1997* (May 1997); and Bureau of the Census, *Populations at Risk*, No. 5, for ENI/PCS (July 1996).

Table 18: Poverty in 1993-1995 (percent)

Less than:	\$3.30/day (UNDP)	\$4/day (EBRD)	\$4/day (Milanovic)	\$4/day adj. (Milanovic)
Czech Republic	0	1	LT 1	LT 1
Slovakia	10	1	LT 1	LT 1
Slovenia	0	1	LT 1	LT 1
Hungary	0	2	4	2
Poland	0	13	20	14
Bulgaria	10	33	15	15
Belarus	10	23	22	22
Latvia	20	23	22	22
Romania	10	22	59	28
Lithuania	10	46	30	30
Estonia	20	40	37	37
Uzbekistan	50	29	63	39
Armenia	40	44	---	---
Georgia	40	---	---	---
Russia	30	38	50	44
Azerbaijan	50	---	---	---
Turkmenistan	20	48	61	57
Kazakhstan	30	50	65	62
Ukraine	50	41	63	63
Moldova	40	65	66	66
Kyrgyzstan	80	76	88	86
Tajikistan	100	---	---	---
Albania	---	---	---	---
Croatia	---	---	---	---
Macedonia	---	---	---	---
Bosnia-Herzegovina	---	---	---	---

UNDP, *Poverty in Transition?* (July 1998); EBRD, *Transition Report 1998* (November 1998); Milanovic, *Income, Inequality, and Poverty during the Transition from Planned to Market Economy* (World Bank, 1998).

Poverty is estimated by Milanovic using 2 sets of income data: data from household surveys; & the same data adjusted for possible understatements of income (by using macroeconomic data on household income).

Table 19. Poverty and Poverty Gap at \$2 per Day

	Year	Poverty Rate	Poverty Gap
Belarus	1993	6.4	0.8
Russia	1993	10.9	2.3
Kazakhstan	1993	12.1	2.5
Lithuania	1993	18.9	4.1
Bulgaria	1992	23.5	6.0
Turkmenistan	1993	25.8	7.6
Poland	1993	15.1	7.7
Moldova	1992	30.6	9.7
Estonia	1994	32.5	10.0
Kyrgyzstan	1993	55.3	21.4
CEE & NIS	1992-94	23.1	7.2
CEE	1992-94	22.5	7.0
NIS	1992-93	23.5	7.4
Latin America	1989-95	48.6	23.5
Jamaica	1993	24.9	7.5
Chile	1992	38.5	16.0
Brazil	1995	43.5	22.4
Ecuador	1994	65.8	29.6
Guatemala	1989	76.8	47.6
Asia	1990-95	54.4	21.7
Thailand	1992	23.5	5.4
Indonesia	1996	50.4	15.3
China	1995	57.8	24.1
Philippines	1994	62.8	27.0
Nepal	1994	86.7	44.6
Africa	1981-93	77.1	44.1
Cote d'Ivoire	1988	54.8	20.4
Zimbabwe	1990-91	68.2	35.5
Kenya	1992	78.1	44.4
Uganda	1989-90	92.2	56.6
Guinea-Bissau	1991	96.7	76.6

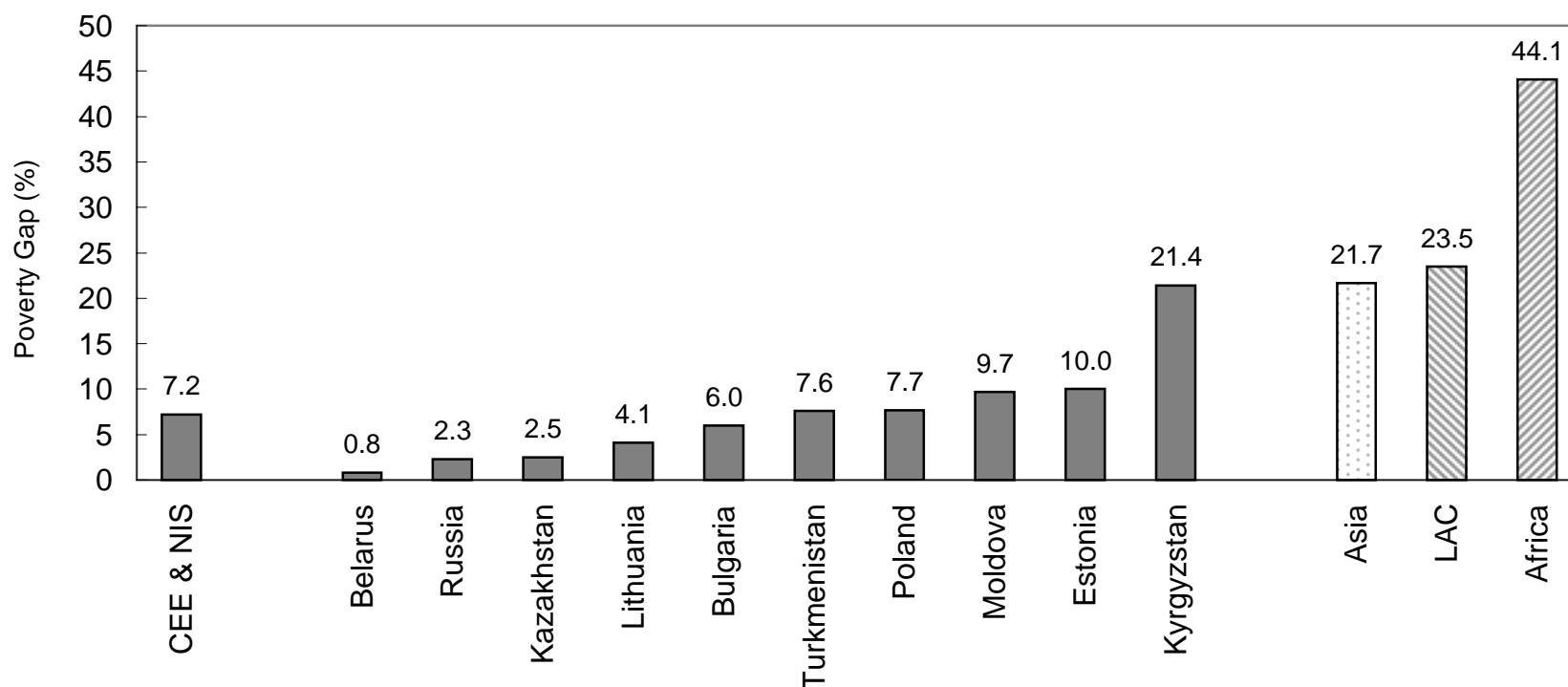
Note: Poverty gap is the average shortfall below the poverty line of those in poverty, as a % of the poverty line; i.e., it reflects the depth of poverty. Regional averages for CEE & NIS are based on 10 countries from 1992 to 1994; LAC--13 countries, 1989 to 1995; Asia--9 countries, 1990 to 1995; and Africa--16 countries, 1981 to 1993.

World Bank, World Development Indicators (March 1999).

Figure 3: Poverty Gap in Transition Countries

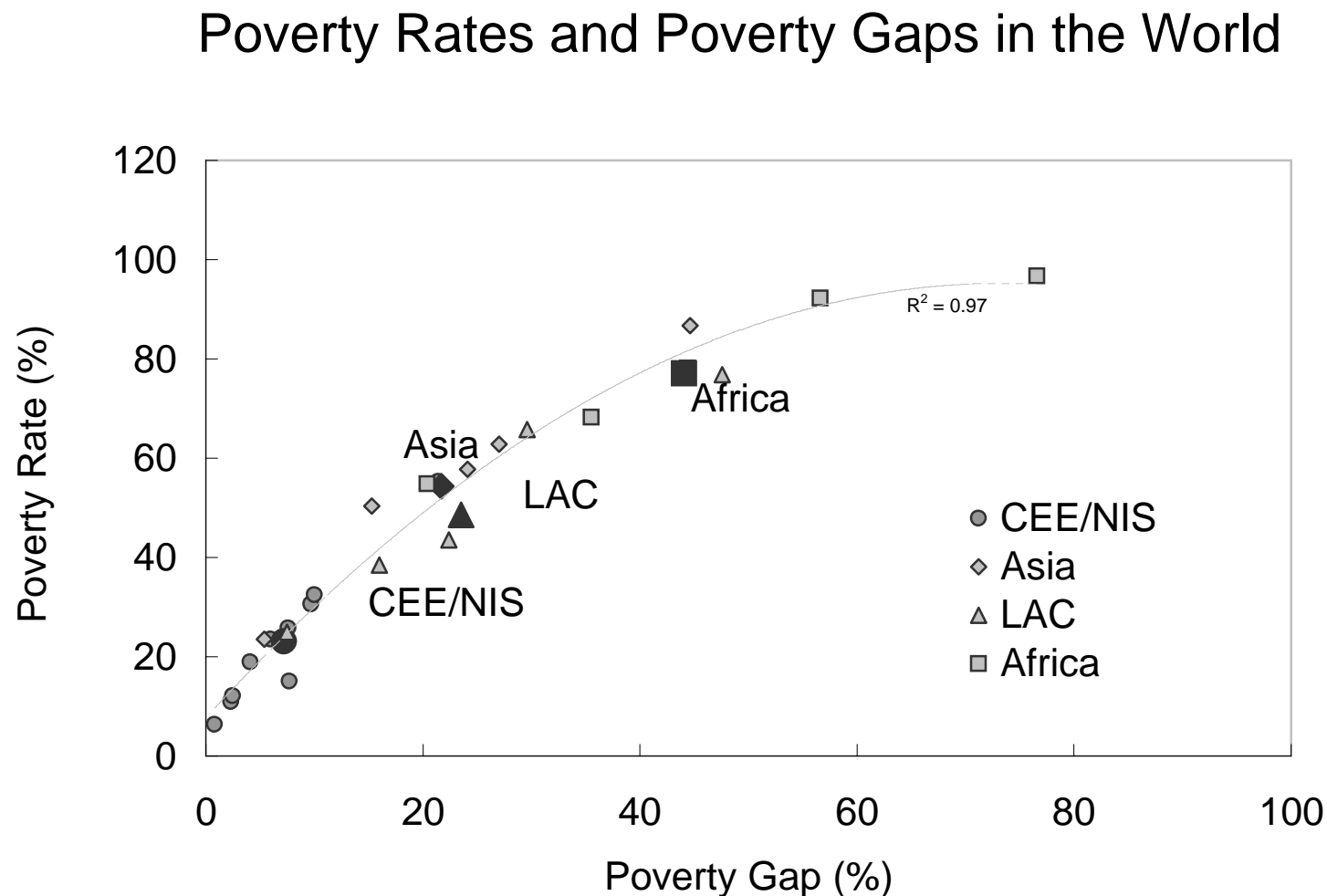
Shallow Poverty in the Early Transition

(poverty gap at \$2/day)



Note: Poverty gap is the average shortfall below the poverty line of those in poverty, as a % of the poverty line; i.e., it reflects the depth of poverty. Regional averages for CEE & NIS are based on 10 countries from 1992 to 1994; LAC--13 countries, 1989 to 1995; Asia--9 countries, 1990 to 1995; and Africa--16 countries, 1981 to 1993. World Bank, *World Development Indicators* (March 1999).

Figure 4: Poverty Rates and Poverty Gaps



Note: Poverty rate is the percent of people living below the poverty line of \$2 per day. Poverty gap is the average shortfall below the poverty line of those in poverty, as a % of the poverty line; i.e., it reflects the depth of poverty. Regional averages (represented on graph by large solid symbols) for CEE & NIS are based on 10 countries from 1992 to 1994; LAC--13 countries, 1989 to 1995; Asia--9 countries, 1990 to 1995; and Africa--16 countries, 1981 to 1993. World Bank, *World Development Indicators* (March 1999).

Table 20. Infant Mortality and Life Expectancy

	Infant Mortality				Life Expectancy					
	1989	1993	1997	% Change 1989-97	Male			Female		
					1989	1997	% change	1989	1997	% change
Czech Republic	10	9	6	-41	68	71	3.5	75	78	2.8
Slovenia	8	7	5	-37	69	71	3.2	77	79	2.5
Armenia	20	17	15	-25	69	70	1.9	75	77	3.5
Slovakia	14	11	9	-36	67	69	3.0	75	77	1.7
Poland	19	16	10	-47	67	69	2.5	76	77	2.0
Hungary	16	13	10	-37	65	66	1.5	74	75	1.8
Yugoslavia	29	22	14	-52	69	70	1.3	74	75	1.2
FYR Macedonia	37	24	16	-57	70	70	0.7	74	75	1.5
Turkmenistan	55	46	40	-27	62	62	0.8	68	69	1.3
Azerbaijan	26	28	20	-25	66	67	1.5	74	75	0.5
Georgia	20	18	17	-12	68	69	0.6	76	77	1.5
Croatia	12	10	9	-27	68	68	0.1	76	77	1.7
Uzbekistan	38	32	..	...	66	66	0.2	72	72	0.4
Estonia	15	16	10	-32	66	64	-1.9	75	76	1.7
Tajikistan	43	47	30	-31	66	66	-1.1	71	71	0.6
Lithuania	11	16	10	-4	67	66	-1.5	76	77	0.7
Romania	27	23	22	-18	67	65	-2.1	73	73	0.4
Albania	31	33	26	-16	70	69	-1.1	76	75	-1.1
Latvia	11	16	15	38	65	64	-2.3	75	75	-0.4
Bulgaria	14	16	18	22	69	67	-2.0	75	74	-0.9
Kyrgyzstan	32	32	28	-12	64	63	-2.5	72	71	-0.6
Moldova	..	22	20	-7	66	63	-4.0	72	70	-2.8
Russia	18	20	17	-4	64	61	-5.0	75	73	-1.9
Belarus	12	13	12	5	67	63	-6.3	76	74	-2.6
Ukraine	13	15	14	8	66	62	-6.2	75	73	-2.9
Kazakhstan	26	28	24	-7	64	60	-6.6	73	70	-3.4
Bosnia-Herzegovina	18	23	13	-31	69	..	...	74	..	...
CEE & NIS	20	20	16	-20	66	64	-2.7	74	74	-0.8
Northern Tier CEE	16	14	9	-40	67	68	2.2	75	77	1.9
Southern Tier CEE	24	21	18	-26	68	67	-1.1	74	74	0.2
NIS	21	22	18	-14	65	62	-4.3	74	73	-1.7
LDCs			60			63			67	
<i>Middle-income</i>			35			67			71	
OECD			10			73			79	
EU			5			74			81	
Benchmarks			30	no worsening			no worsening			no worsening

Note: Infant mortality rate is per 1,000 live births; and life expectancy is in years. The OECD infant mortality rate average is significantly pulled up by 2 members: Turkey at 40 and Mexico at 31. Percent change in infant mortality is calculated from 1993 to 1997 for Moldova.

World Bank, *World Development Indicators 1999* (March 1999).

Table 21. Human Development

Country	Secondary School Enrollment				Human Development Index			
	(% of age group)				1993		1995	
	1990	1993	1996 ¹	% change ²	Score ³	Rank	Score	Rank
Slovenia	91.1	90.3	91.7	0.7	0.886	35	0.887	37
Czech Republic	91.2	91.8	98.7	8.2	0.872	37	0.884	39
Slovakia	..	88.6	94.0	6.1	0.864	41	0.875	42
Hungary	78.6	94.3	97.8	24.4	0.855	46	0.857	47
Poland	81.5	93.9	97.6	19.8	0.819	56	0.851	52
Bulgaria	75.2	70.1	76.8	2.1	0.773	62	0.789	67
Belarus	93.0	90.9	92.9	-0.1	0.787	61	0.783	68
Russia	93.3	87.0	..	-6.8	0.804	57	0.769	72
Romania	92.0	79.4	78.4	-14.8	0.738	74	0.767	74
Croatia	76.2	82.8	81.8	7.3	0.760	77	0.759	76
Estonia	101.9	93.9	103.8	1.9	0.749	68	0.758	77
Lithuania	91.9	80.9	86.3	-6.1	0.719	81	0.750	79
FYR Macedonia	55.7	57.3	62.9	12.9	0.748	80	0.749	80
Latvia	92.7	87.0	83.7	-9.7	0.820	55	0.704	92
Kazakhstan	98.0	92.0	87.0	-11.2	0.740	72	0.695	93
Armenia	..	88.0	90.0	2.3	0.680	93	0.674	99
Ukraine	92.8	91.2	..	-1.7	0.719	80	0.665	102
Turkmenistan	..	..	..	...	0.695	90	0.660	103
Uzbekistan	99.0	94.0	..	-5.1	0.679	94	0.659	104
Albania	78.3	41.2	37.5	-52.1	0.633	104	0.656	105
Georgia	95.0	77.0	77.0	-18.9	0.645	101	0.633	108
Kyrgyzstan	100.0	90.0	79.0	-21.0	0.663	99	0.633	109
Azerbaijan	90.0	87.0	77.0	-14.4	0.665	96	0.623	110
Moldova	80.0	84.0	80.5	0.6	0.663	98	0.610	113
Tajikistan	102.0	82.0	78.0	-23.5	0.616	105	0.575	118
CEE & NIS	90.4	87.0	85.5	-2.9	0.75		0.75	
Northern Tier CEE	84.2	92.3	96.5	14.7	0.81		0.85	
Southern Tier CEE	79.5	71.4	71.7	-8.7	0.74		0.76	
NIS	94.0	88.5	84.0	-6.5	0.76		0.72	
European Union	96.7	108.4	108.4	12.1	0.92		0.93	...
Colombia	49.8	57.7	66.7	33.9			0.85	53
Ecuador	55.3	48.5	..	-12.3			0.77	73
Dominican Republic	..	36.7	..	...			0.72	88
Benchmark	no decline in enrollment							

¹1995 figures for Czech Republic, Hungary, and Poland. ²Change in secondary school enrollment for Armenia and Slovakia is from 1993 to 1996; for Russia, Ukraine, and Uzbekistan, from 1990 to 1993. ³The HDI ranges from 0 to 1; the higher the value, the greater the human development. HDI figures for Croatia, FYR Macedonia, and Slovenia are for 1994 and 1995.

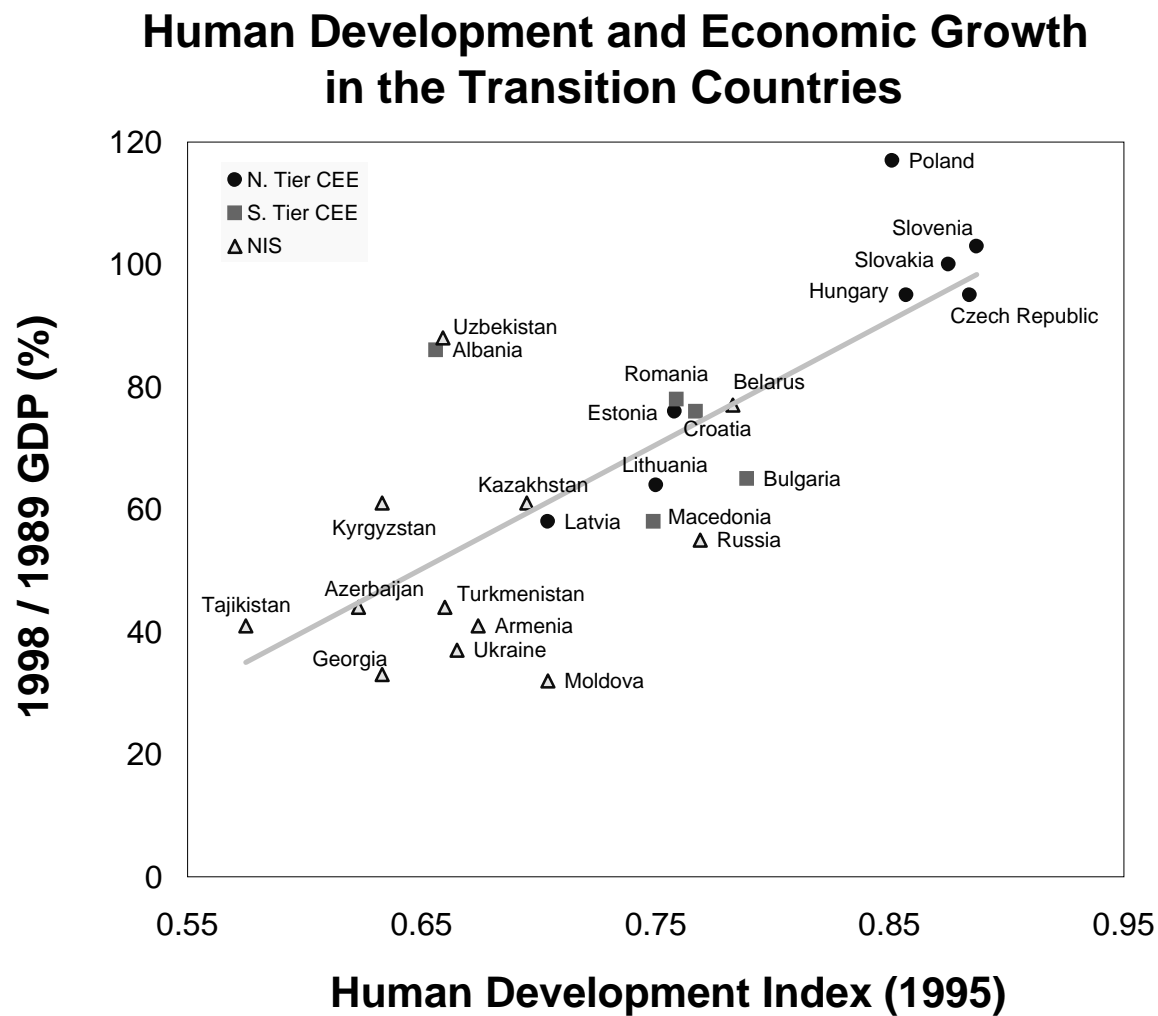
Source: UNESCO/USAID, *Global Education Database 1998* (May 1999); UNDP, *Human Development Report* (September 1998 and earlier editions).

Table 22. Environment

Country	Environmental Quality							Efficiency
	CO ₂ Emissions	CO ₂ Emissions	CO ₂ Emissions	Air Pollution Concentrations (1995)				GDP per unit
	per capita	per capita	per unit of GDP	micrograms/m ³				of energy
	(1992)	(1996)	(1996)	City	SO ₂	NO ₂	TSP	(1996)
Slovenia	5.1	6.6	0.7	...	...	...	...	3.1
Croatia	3.4	3.7	0.9	Zagreb	31	...	71	2.8
Albania	0.9	0.6	0.7	...	...	...	...	2.2
Georgia	2.8	0.6	0.9	...	...	...	...	2.1
Hungary	5.6	5.8	1.3	Budapest	39	51	63	1.8
Armenia	1.0	1.0	1.2	...	...	...	...	1.7
Latvia	5.0	3.7	1.4	...	...	...	...	1.6
Czech Republic	13.7	12.3	2.4	Prague	32	23	59	1.3
Kyrgyzstan	2.6	1.3	1.7	...	...	...	...	1.2
Poland	8.8	9.2	2.8	Warsaw	16	32	...	1.2
(Poland)	...	...	...	Katowice	83	79	...	...
(Poland)	...	...	...	Lodz	21	43	...	...
Slovakia	8.1	7.4	2.1	Bratislava	21	27	62	1.1
Estonia	13.8	11.2	3.3	...	...	...	...	0.9
Lithuania	5.7	3.7	1.9	...	...	...	...	0.8
Belarus	9.1	6.0	3.3	...	...	...	...	0.8
Romania	5.4	5.3	3.5	Bucharest	10	71	82	0.7
Moldova	5.0	2.8	4.2	...	...	...	...	0.6
Russia	13.1	10.7	4.7	Moscow	109	...	100	0.5
(Russia)	...	...	...	Omsk	9	30	100	...
Uzbekistan	5.0	4.1	4.2	...	...	...	...	0.5
Bulgaria	6.1	6.6	4.7	Sofia	39	122	195	0.5
Ukraine	12.1	7.8	5.1	Kyiv	14	51	100	0.5
Kazakhstan	17.7	10.9	8.7	...	...	...	...	0.5
Tajikistan	3.8	1.0	3.7	...	...	...	...	0.5
Turkmenistan	8.5	7.5	8.2	...	...	...	...	0.4
Azerbaijan	6.4	4.0	8.5	...	...	...	...	0.3
Bosnia-Herzegovina	0.9	1.4	...	...	...	...	...	...
FYR Macedonia	5.5	6.4	6.1	...	...	...	...	...
Yugoslavia	...	...	...	...	...	...	...	...
CEE & NIS	10.1	8.1	4.3		35	53	92	0.8
Northern Tier CEE	8.7	8.6	2.4		35	43	61	1.3
Southern Tier CEE	4.6	4.8	3.3		27	97	116	1.1
NIS	11.3	8.5	4.9		44	41	100	0.6
European Union	9.3	9.2	0.4		12	46	47	5.8

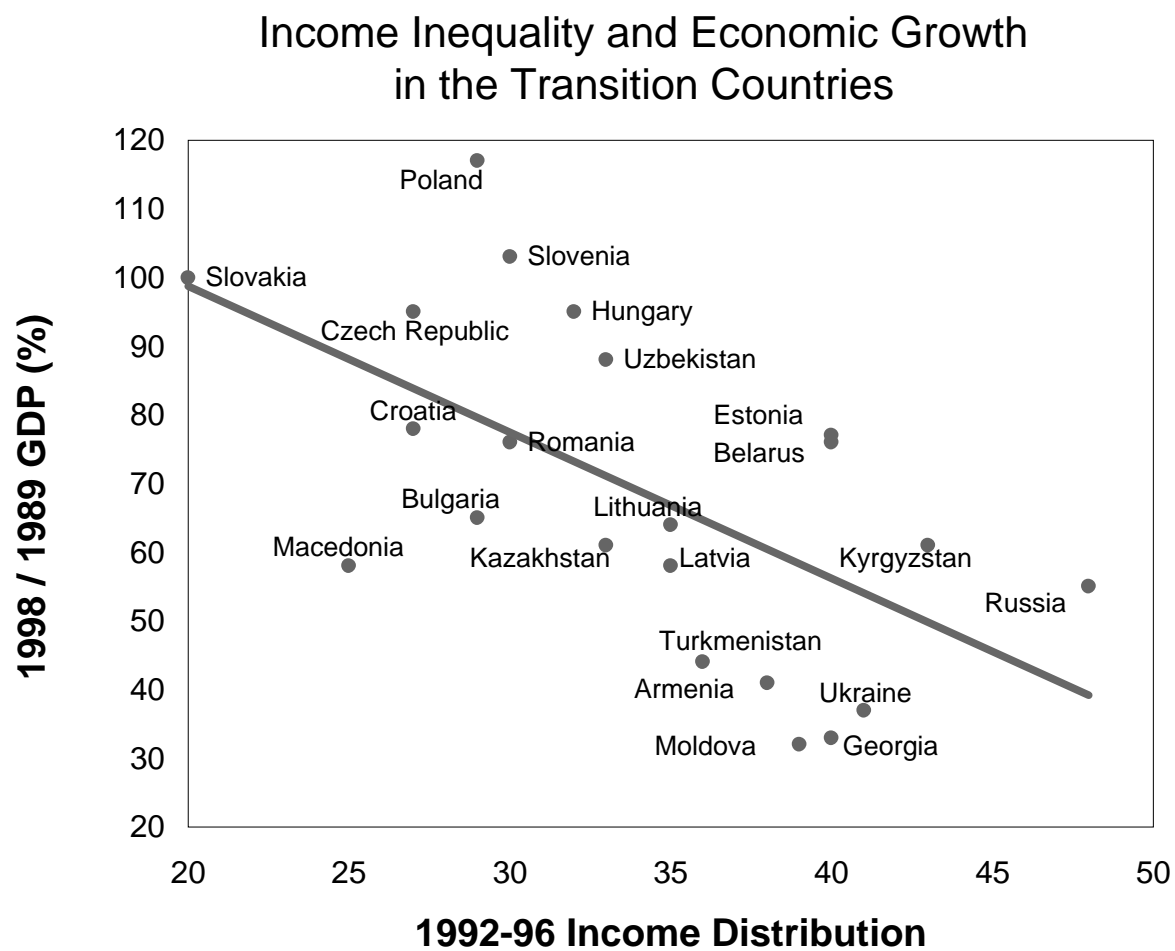
Note: CO₂ emissions are measured in metric tons per capita and kg per dollar of GDP (in constant 1995 dollars). Air pollution concentrations are annual mean concentrations of sulphur dioxide (micrograms/m³ of SO₂), nitrogen dioxide (micrograms/m³ of NO₂), and total suspended particulates (micrograms/m³ of TSP) for major cities in 1995. EU average is derived from data for 13 countries. GDP per unit of energy use is the U.S. dollar estimate of real GDP (at 1995 prices) per kilogram of oil equivalent of commercial energy use
World Bank, *World Development Indicators 1999* (March 1999); EBRD, *Transition Report 1996* (November 1996).

Figure 5



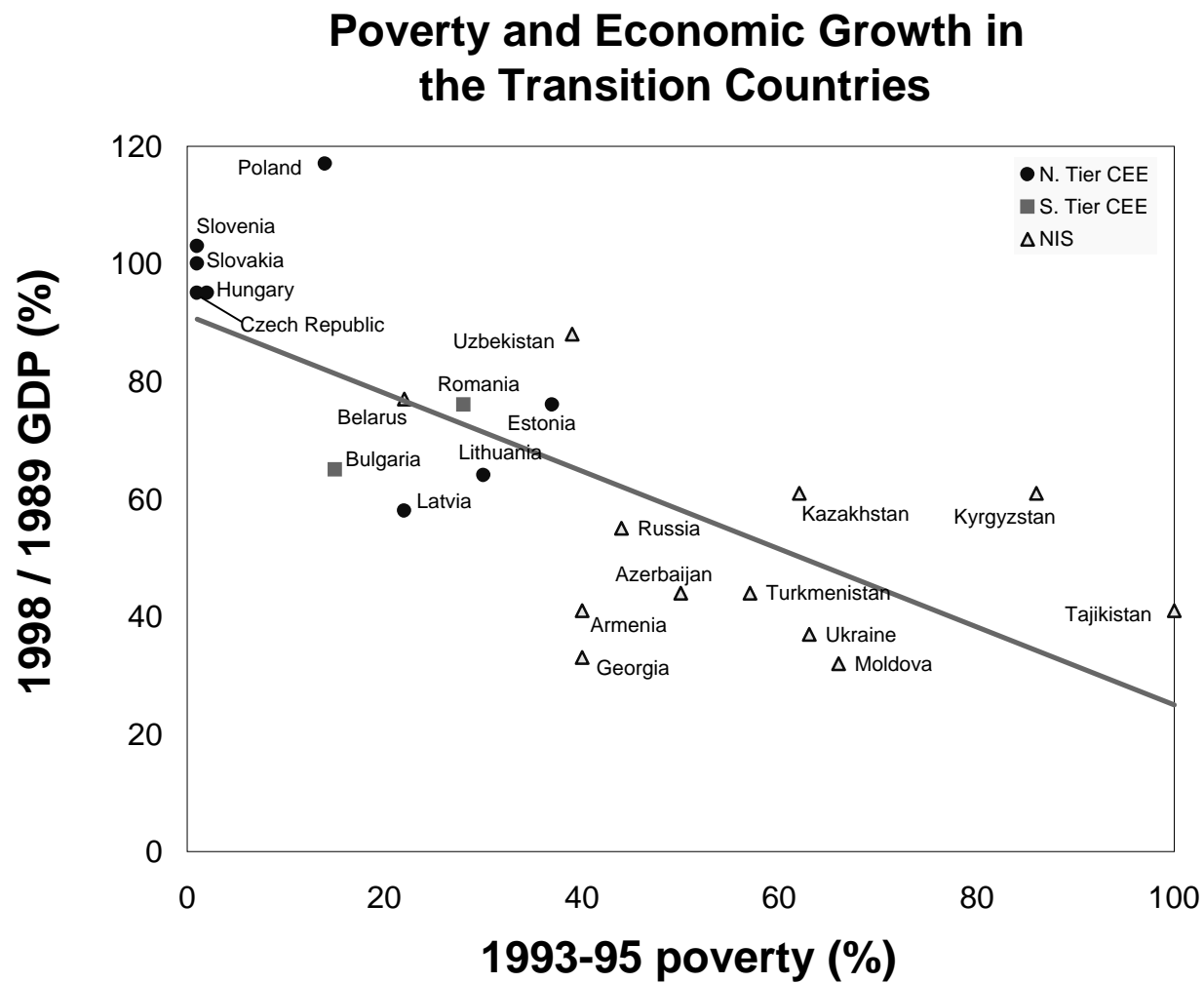
Note: The Human Development Index (HDI) is based on three indicators using 1995 data: longevity, as measured by life expectancy; educational attainment, as measured by a combination of adult literacy and combined primary, secondary, and tertiary enrollment ratios; and standard of living, as measured by real per capita GDP (\$PPP). The HDI ranges from 0 to 1, with higher values representing greater human development. UNDP, *Human Development Report 1998* (May 1998); EBRD, *Transition Report Update* (April 1999).

Figure 6



Note: Income distribution is measured by the Gini Coefficient, which ranges from 0 to 100; the higher the figure, the greater the inequality.
Source: EBRD, *Transition Report Update* (April 1999); World Bank, *World Development Report 1998-1999* (November 1998); UNICEF, *Education for All?*, The MONEE Project, #5 (1998).

Figure 7



Note: Overall poverty rates for most countries measure the percent of population in 1993-95 living below poverty line of \$120 per capita per month at 1990 international prices; for Armenia, Azerbaijan, Georgia and Tajikistan the poverty threshold is \$100 per month. Economic growth is measured by 1998 real GDP as a percent of 1989 level. Data are from EBRD, *Transition Report Update* (April 1999), Branko Milanovic, *Income, Inequality, and Poverty during the Transition from Planned to Market Economy* (World Bank, 1998), and UNDP, *Poverty in Transition?* (July 1998).

IV. Concluding Remarks

Decisions on the magnitude and duration of U.S. assistance to the ENI region are made on the basis of several factors:

- (a) progress the country has made toward a sustainable transition to a market-based democracy;
- (b) strategic importance of the country to the United States;
- (c) importance of the recipient country to U.S. citizens; and
- (d) effectiveness of particular assistance activities.

This paper has presented an approach to analyzing the first factor. The second and third are not as readily quantifiable but are matters of judgment that are regularly considered, along with the first, in making country-level budget decisions. The fourth factor, based on both regular reporting against strategic objective targets and on occasional field-based evaluations, is used primarily to inform the allocation of country budget levels among strategic objectives but is also a basis for determining whether a country assistance program is having enough impact to warrant continuation.

USAID collects, analyzes, and reports on the country performance indicators two times a year. Inter-agency reviews are held as a means to assess the data and to better take stock of progress in the region. These data are also provided to the State Department-based Coordinators for U.S. Assistance to CEE and the NIS and discussed with them when country planning levels are determined.

The overall rankings of the ENI countries in terms of economic policy reforms and democratic freedoms (as depicted in the *Summary Table*) provide a rough guide to policy in this regard. Countries ranked near the top of the list are obvious candidates for earlier “graduation.” Countries near the bottom of the list would seem to fall into one of three contrasting categories: (1) those where assistance is least likely to be effective, in which case it may make sense to close those programs down altogether or to keep highly targeted funding at minimal levels until their commitment to reform increases; (2) these where reform now appears likely but requires greater resources; or (3) those which possess characteristics that match well with the Agency's priorities for sustainable development programs. Countries in the middle of the list are likely candidates for continuing programs through existing funding mechanisms, as long as the assistance is effective and Congress continues to appropriate funds for this purpose.

**MONITORING COUNTRY PROGRESS
IN CENTRAL AND EASTERN EUROPE &
THE NEW INDEPENDENT STATES**

APPENDIX I: REFORM INDICATORS

**APPENDIX II: CROSS-BORDER SPILLOVERS:
KOSOVO
GLOBAL FINANCIAL CRISIS**

USAID/ENI/PCS
OFFICE OF PROGRAM COORDINATION AND STRATEGY
BUREAU FOR EUROPE & THE NEW INDEPENDENT STATES
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

JULY 1999

APPENDIX I: ECONOMIC & DEMOCRATIC REFORM INDICATORS

A. Economic Policy Reforms: Indicators & Description of EBRD's Rating Categories

First Stage Reforms

Small-scale Privatization

- 1 Little progress
- 2 Substantial share privatized
- 3 Nearly comprehensive program implemented, but design or lack of government supervision leaves important issues unresolved (e.g. lack of tradability of ownership rights)
- 4 Complete privatization of small companies with tradable ownership rights
- 5 Standards and performance typical of advanced industrial economies: no state ownership of small enterprises; effective tradability of land

Price Liberalization

- 1 Most prices formally controlled by the government
- 2 Price controls for several important product categories, including key infrastructure products such as utilities and energy; state procurement at non-market prices remains substantial
- 3 Substantial progress on price liberalization including for energy prices; state procurement at non-market prices largely phased out
- 4 Comprehensive price liberalization; utility pricing ensuring cost recovery
- 5 Standards and performance typical of advanced industrial economies: comprehensive price liberalization; efficiency-enhancing regulation of utility pricing

Trade & Foreign Exchange System

- 1 Widespread import and/or export controls or very limited legitimate access to foreign exchange
- 2 Some liberalization of import and/or export controls; almost full current account convertibility in principle but with a foreign exchange regime that is not fully transparent (possibly with multiple exchange rates)
- 3 Removal of most quantitative and administrative import and export restrictions (apart from agriculture) and all significant export tariffs; insignificant direct involvement in exports and imports by ministries and state-owned trading companies; no major non-uniformity of customs duties for non-agricultural goods and services.
- 4 Removal of all quantitative and administrative import and export restrictions (apart from agriculture) and all significant export tariffs; insignificant direct involvement in exports and imports by ministries and state-owned trading companies; no major non-uniformity of customs duties for non-agricultural goods and services
- 5 Standards and performance norms of advanced industrial economies: removal of most tariff barriers; membership in WTO

Extensiveness of Legal Reform for Investment:

- 1 Legal rules concerning pledge, bankruptcy and company law are very limited in scope. Laws impose substantial constraints on the creation, registration and enforcement of security over movable assets, and may impose significant notarization fees on pledges. Company laws do not

ensure adequate corporate governance or protect shareholders' rights. Bankruptcy laws do not provide for certainty or clarity with respect to the definition of an insolvent debtor, the scope of reorganization proceedings or the priority of distribution to creditors following liquidation. Laws in these substantive areas often have not been amended to approximate those of more developed countries and the laws that have been amended contain ambiguities or inconsistencies.

2 Legal rules concerning pledge, bankruptcy and company law are limited in scope and are subject to conflicting interpretations. Legislation may have been amended but new laws do not necessarily approximate those of more developed countries. Specifically, the registration and enforcement of security over movable assets has not been adequately addressed, leading to uncertainty with respect to the registration and enforcement of pledges. Pledge laws may impose significant notarization fees on pledges. Company laws do not ensure adequate corporate governance or protect shareholders' rights. Laws may contain inconsistencies or ambiguities concerning, inter alia, the scope of reorganization proceedings and/or the priority of secured creditors in bankruptcy.

3 New or amended legislation has recently been enacted in at least two of the three areas that were the focus of this survey--pledge, bankruptcy or company law--but could benefit from further refinement and clarification. Legal rules permit a non-possessory pledge over most types of movable assets. However, the mechanisms for registration of the security interest are still rudimentary and do not provide parties with adequate protection. There is scope for enforcement of pledges without court assistance. Company laws may contain limited provisions for corporate governance and the protection of shareholders' rights. Bankruptcy legislation contains provisions for both reorganization and liquidation but may place claims of other creditors in priority to those of secured creditors in liquidation.

4 Comprehensive legislation exists in at least two of the three areas of commercial law that were the focus of this survey--pledge, bankruptcy and company law. Pledge law allows parties to take non-possessory pledges in a wide variety of movable property and contains mechanisms for enforcement of pledges without court assistance. The legal infrastructure, however, is not fully developed to include a centralized or comprehensive mechanism for registering pledges. Company laws contain provisions for corporate governance and the protection of shareholders' rights. Director and officer duties are defined. Bankruptcy law includes detailed provisions for reorganization and liquidation. Liquidators possess a wide variety of powers to deal with the property and affairs of a bankrupt.

5 Comprehensive legislation exists in all three areas of commercial law--pledge, bankruptcy and company law. Legal rules closely approach those more developed countries. These legal systems have a uniform (i.e., centralized registration) system for the taking and enforcement of a security interest in movable assets and also provide for adequate corporate governance and protect shareholders' rights. In particular the rights of minority shareholders are protected in the event of the acquisition by third parties of less than all of the shares of a widely held company. Bankruptcy law provides in a comprehensive manner for both reorganization and liquidation. Liquidators possess a wide variety of powers and duties to deal with the property and affairs of a bankrupt, including wide powers of investigation of pre-bankruptcy transactions carried out by the debtor. There are specialized courts that handle bankruptcy proceedings. Liquidators must possess certain minimum qualifications

Second Stage Reforms

Large-scale Privatization

- 1 Little private ownership
- 2 Comprehensive scheme almost ready for implementation; some sales completed
- 3 More than 25 percent of large-scale state-owned enterprise assets privatized or in the process of being sold, but possibly with major unresolved issues regarding corporate governance
- 4 More than 50 percent of state-owned enterprise assets privatized in a scheme that has generated substantial outsider ownership
- 5 Standards and performance typical of advanced industrial economies: more than 75 percent of enterprise assets in private ownership with effective corporate governance

Governance & Enterprise Restructuring

- 1 Soft budget constraints (lax credit and subsidy policies weakening financial discipline at the enterprise level); few other reforms to promote corporate governance
- 2 Moderately tight credit and subsidy policy but weak enforcement of bankruptcy legislation and little action taken to break up dominant firms
- 3 Significant and sustained actions to harden budget constraints and to promote corporate governance effectively (e.g. through privatization combined with tight credit and subsidy policies and/or enforcement of bankruptcy legislation)
- 4 Strong financial discipline at the enterprise level; substantial improvement in corporate governance through government restructuring program or an active corporate control market; significant action to break up dominant firms; significant new investment at the enterprise level
- 5 Standards and performance typical of advanced industrial economies: effective corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring

Competition Policy

- 1 No competition legislation and institutions; widespread entry restrictions
- 2 Competition policy legislation and institutions set up; some reduction of entry restrictions or enforcement action on dominant firms
- 3 Some enforcement actions to reduce abuse of market power and to promote a competitive environment, including break-ups of dominant conglomerates; substantial reduction of entry restrictions
- 4 Significant enforcement actions to reduce abuse of market power and to promote a competitive environment
- 5 Standards and performance typical of advanced industrial economies: effective enforcement of competition policy; unrestricted entry to most markets

Banking Reform

- 1 Little progress beyond establishment of a two-tier system
- 2 Significant liberalization of interest rates and credit allocation; limited use of directed credit or interest rate ceilings
- 3 Substantial progress in establishment of bank solvency and of a framework for prudential supervision and regulation; full interest rate liberalization with little preferential access to cheap refinancing; significant lending to private enterprises and significant presence of private banks

- 4 Significant movement of banking laws and regulations towards BIS standards; well-functioning banking competition and effective prudential supervision; significant term lending to private enterprises; substantial financial deepening
- 5 Standards and performance norms of advanced industrial economies: full convergence of banking laws and regulations with BIS standards; provision of full set of competitive banking services

Non-Bank Financial Institutional Reform

- 1 Little progress
- 2 Formation of securities exchanges, market-makers and brokers; some trading in government paper and/or securities; rudimentary legal and regulatory framework for the issuance and trading of securities
- 3 Substantial issuance of securities by private enterprises; establishment of independent share registries, secure clearance and settlement procedures, and some protection of minority shareholders; emergence of non-bank financial institutions (e.g. investment funds, private insurance and pension funds, leasing companies) and associated regulatory framework
- 4 Securities laws and regulations approaching IOSCO standards; substantial market liquidity and capitalization; well-functioning non-bank financial institutions and effective regulation
- 5 Standards and performance norms of advanced industrial economies: full convergence of securities laws and regulations with IOSCO standards; fully developed non-bank intermediation

Effectiveness of Legal Rules for Investment

- 1 Commercial legal rules are usually very unclear and sometimes contradictory. The administration and judicial support for the law is rudimentary. The cost of transactions, such as creating a pledge over a movable asset is prohibitive so as to render a potentially extensive law ineffective. There are no meaningful procedures in place in order to make commercial laws fully operational and enforceable. There are significant disincentives for creditors to seek the commencement of bankruptcy proceedings in respect of insolvent debtors.
- 2 Commercial legal rules are generally unclear and sometimes contradictory. There are few, if any meaningful procedures in place in order to make commercial laws operational and enforceable.
- 3 While commercial legal rules are reasonably clear, administration or judicial support of the law is often inadequate or inconsistent so as to create a degree of uncertainty (e.g., substantial discretion in the administration of laws, few up-to-date registries for pledges).
- 4 Commercial laws are reasonably clear and administrative and judicial support of the law is reasonably adequate. Specialized courts, administrative bodies or independent agencies may exist for the liquidation of insolvent companies, the registration of publicly traded shares or the registration of pledges.
- 5 Commercial laws are clear and readily ascertainable. Commercial law is well supported administratively and judicially, particularly regarding the efficient functioning of courts, liquidation proceedings, the registration of shares and the orderly and timely registration of security interests.

Infrastructure. This indicator averages EBRD ratings for reform progress in telecommunications, railways, and electric power. The three component scores are in the EBRD, *Transition Report* (November 1998), p. 44.

Telecommunications

Little progress in commercialization and regulation, i.e., minimal degree of private sector involvement, strong political interference in management, lack of cost-effective tariff-setting principles and extensive cross-subsidization. Few other institutional reforms to encourage liberalization envisaged, even for mobile phones and value-added services.

2 Modest progress in commercialization, i.e., corporatization of the dominant operator and some separation of operation from public sector governance, but tariffs still politically determined.

3 Substantial progress in commercialization and regulation. Full separation of telecommunications from postal services, with reduction in the extent of cross subsidization. Some liberalization in the mobile segment and in value-added services.

4 Complete commercialization (including the privatization of the dominant operator) and comprehensive regulatory and institutional reforms. Extensive liberalization of entry.

5 Implementation of a coherent and effective institutional and regulatory framework (including the operation of an independent regulator) encompassing tariffs, interconnection rules, licensing, concession fees and spectrum allocation. Existence of a consumer ombudsman function.

(b) Railways

1 Monolithic organizational structures. State railways still effectively operated as government departments. Few commercial freedoms to determine prices or investments. No private sector involvement. Cross-subsidization of passenger service public service obligations with freight service revenues.

2 Laws distancing rail operations from the state, but weak commercial objectives. No budgetary funding of public service obligations in place. Organizational structures still overly based on geographic/functional areas. Separation of ancillary businesses but little divestment. Minimal encouragement of private sector involvement. Initial business planning, but targets general and tentative.

3 Laws passed to restructure the railways and introduce commercial orientation. Separation of freight and passenger marketing groups grafted onto tradition structures. Some divestment of ancillary businesses. Some budgetary compensation for passenger services. Design of business plans with clear investment and rehabilitation targets. Business plans designed, but funding unsecured. Some private sector involvement in rehabilitation and/or maintenance.

4 Laws passed to fully commercialize railways. Creation of separate internal profit centers for passenger and freight (actual or imminent). Extensive market freedoms to set tariffs and investments. Medium-term business plans under implementation. Ancillary industries divested. Policy development to promote commercial (including private) rail transport operations.

5 Railway law exists allowing for separation of infrastructure from operations, and/or freight from passenger operations, and/or private train operations. Private sector participation in ancillary services and track maintenance. Establishment of rail regulator and/or implementation of access pricing and/or plans for a full divestment and transfer of asset ownership, including infrastructure and rolling stock.

(c) Electric power

- 1 Power sector operated as a government department; political interference in running the industry. Few commercial freedoms or pressures. Average prices below costs, with external and implicit subsidy and cross-subsidy. Very little institutional reform with monolithic structure and no separation of different parts of the business.
- 2 Power company is distance from government. For example, established as a joint-stock company, though there is still political interference. Some attempt to harden budget constraints, but management incentives for efficient performance are weak. Some degree of subsidy and cross-subsidy. Little institutional reform; monolithic structure with no separation of different parts of the business. Minimal private sector involvement.
- 3 Law passed which provides for full-scale restructuring of the industry, including vertical unbundling through accounting separation, setting up of regulator with some distance from the government, plans for tariff reform if effective tariffs are below cost, possibility of private ownership and industry liberalization. Little or no private sector involvement.
- 4 Law for industry restructuring passed and implemented providing for: separation of the industry into generation, transmission and distribution; setting up of a regulator, with rules for setting cost-reflective tariffs formulated and implemented. Arrangements for network access (negotiated access, single buyer model) developed. Substantial private sector involvement in distribution and/or generation.
- 5 Business separated vertically into generation, transmission and distribution. Existence of an independent regulator with full power to set cost-reflective tariffs. Large-scale private sector involvement. Institutional development covering arrangements for network access and full competition in generation.

Environmental Policy Reform. The environmental policy reform indicator is drawn from EBRD (November 1997). Four components go into it (see table below). The first is the degree of adherence to six key international environmental treaties: the Convention on the Wetlands of International Importance; the Convention on International Trade in Endangered Species of Wild Fauna and Flora; the Montreal Protocol for the control of CFC emissions; the Convention on Climate Change; the Convention on Biodiversity; and the Convention on Environmental Impact in a Transboundary Context. Countries are put into three groups on the basis of their progress towards signing and ratifying these treaties.

The second component attempts to measure progress in air and water ambient and emission (effluent) standards. Three levels of progress are identified: (1) the maximum permissible concentrations (MPC) system in place, broadly based on the former Soviet system; (2) a new system is being introduced, either as an evolution of MPC or in order to meet EU requirements; and (3) essentially new standards system is in place, often following EU requirements.

The third component attempts to measure progress in preparing and implementing national environmental action plans (NEAPs). Countries either have a NEAP planned or under preparation; or they have a NEAP prepared and under implementation.

Finally, the fourth component tries to assess the extent to which environmental financial mechanisms are used. From an EBRD questionnaire sent to the authorities in charge of the

environment in each of the countries, information on four instruments were compiled: (1) existence of an environmental fund for channeling the money collected in fees and fines to environmental investments; (2) provision of taxes/other penalties or financial incentives for energy and resource efficiency; (3) waste and pollution reduction; (4) the use of clean technologies. Countries were grouped in two: those in which three or more financial instruments are in place; and those with less than three instruments in place.

Appendix I. Table 1. Environmental Policy Reform

	Financial				
	Treaties	Standards	NEAPs	Instruments	Average
Czech Republic	5	5	4	4	4.5
Hungary	5	5	4	4	4.5
Poland	5	5	4	4	4.5
Slovakia	5	3	4	4	4.0
Estonia	3	3	4	4	3.5
Latvia	5	3	4	2	3.5
Romania	5	3	4	2	3.5
Russia	5	1	4	4	3.5
Croatia	3	3	2	4	3.0
Lithuania	3	1	4	4	3.0
Moldova	3	1	4	4	3.0
Ukraine	3	1	4	4	3.0
Slovenia	3	3	2	2	2.5
Bulgaria	5	1	2	2	2.5
Belarus	3	1	4	2	2.5
Albania	3	1	4	2	2.5
Georgia	5	1	2	2	2.5
Armenia	3	1	2	2	2.0
Azerbaijan	1	1	2	4	2.0
FYR Macedonia	1	1	4	2	2.0
Kyrgyzstan	1	1	4	2	2.0
Turkmenistan	1	1	4	2	2.0
Kazakhstan	1	1	2	2	1.5
Tajikistan	1	1	2	2	1.5
Uzbekistan	1	1	2	2	1.5
CEE & NIS					3.2
Northern Tier CEE					4.3
Southern Tier CEE					3.1
NIS					2.9

Note: On a 1-5 scale with 5 the most advanced. See text for an elaboration of the components.

Source: EBRD, *Transition Report 1997* (November 1997), pp. 32-33.

B. Democratic Freedoms: Elaboration of Freedom House's Rating Scheme of Political Rights and Civil Liberties

Freedom House annually rates political rights and civil liberties separately on a seven-category scale, 1 representing the most free and 7 the least free. The 1997-1998 Survey included 191 countries and/or territories. The 1-to-7 rating is derived by country teams awarding from 0 to 4 raw points per checklist item (shown below). The highest possible score for political rights is 32 points, based on up to 4 points for each of eight questions. The highest possible score for civil liberties is 52 points, based on up to 4 points for each of thirteen questions. Under the methodology, raw points correspond to category numbers as follows:

<u>Political Rights category number</u>	<u>Raw points</u>
1	28-32
2	23-27
3	19-22
4	14-18
5	10-13
6	5-9
7	0-4

<u>Civil Liberties category number</u>	<u>Raw points</u>
1	45-52
2	38-44
3	30-37
4	23-29
5	15-22
6	8-14
7	0-7

Political Rights checklist

1. Is the head of state and/or head of government or other chief authority elected through free and fair elections?
2. Are the legislative representatives elected through free and fair elections?
3. Are there fair electoral laws, equal campaigning opportunities, fair polling and honest tabulation of ballots?
4. Are the voters able to endow their freely elected representatives with real power?
5. Do the people have the right to organize in different political parties or other competitive political groupings of their choice, and is the system open to the rise and fall of these competing parties or groupings?
6. Is there a significant opposition vote, de facto opposition power, and a realistic possibility for

the opposition to increase its support or gain power through elections?

7. Are the people free from domination by the military, foreign powers, totalitarian parties, religious hierarchies, economic oligarchies or any other powerful group?

8. Do cultural, ethnic, religious and other minority groups have reasonable self-determination, self-government, autonomy or participation through informal consensus in the decision-making process?

Civil Liberties checklist

1. Are there free and independent media, literature and other cultural expressions? (Note: In cases where the media are state-controlled but offer pluralistic points of view, the Survey gives the system credit).

2. Is there open public discussion and free private discussion?

3. Is there freedom of assembly and demonstration?

4. Is there freedom of political or quasi-political organization? (Note: This includes political parties, civic associations, ad hoc groups and so forth.)

5. Are citizens equal under the law, with access to an independent, nondiscriminatory judiciary, and are they respected by the security forces?

6. Is there protection from political terror, and from unjustified imprisonment, exile or torture, whether by groups that support or oppose the system, and freedom from war or insurgency situations? (Note: Freedom from war and insurgency situations enhances the liberties in a free society, but the absence of wars and insurgencies does not in itself make an unfree society free.)

7. Are there free trade unions and peasant organizations or equivalents, and is there effective collective bargaining?

8. Are there free professional and other private organizations?

9. Are there free businesses or cooperatives?

10. Are there free religious institutions and free private and public religious expressions?

11. Are there personal social freedoms, which include such aspects as gender equality, property rights, freedom of movement, choice of residence, and choice of marriage and size of family?

12. Is there equality of opportunity, which includes freedom from exploitation by or dependency on landlords, employers, union leaders, bureaucrats or any other type of denigrating obstacle to a share of legitimate economic gains?

13. Is there freedom from extreme government indifference and corruption?

Political Rights

1 Rating. Generally speaking, places rated 1 come closest to the ideals suggested by the checklist questions, beginning with free and fair elections. Those elected rule. There are competitive parties or other competitive political groupings, and the opposition has an important role and power. These entities have self-determination or an extremely high degree of autonomy. Usually, those rated 1 have self-determination for minority groups or their participation in government through informal consensus. With the exception of such entities as tiny island countries, these countries and territories have decentralized political power and free sub-national elections.

2 Rating. Such factors as gross political corruption, violence, political discrimination against

minorities, and foreign or military influence on politics may be present, and weaken the quality of democracy.

3,4, and 5 Ratings. The same factors that weaken freedom in category 2 may also undermine political rights in categories 3,4, and 5. Other damaging conditions may be at work as well, including civil war, very strong military involvement in politics, lingering royal power, unfair elections and one-party dominance. However, states and territories in these categories may still have some elements of political rights such as the freedom to organize nongovernmental parties and quasi-political groups, reasonably free referenda, or other significant means of popular influence on government.

6 Rating. Typically, such states have systems ruled by military juntas, one-party dictatorships, religious hierarchies and autocrats. These regimes may allow only some minimal manifestation of political rights such as competitive local elections or some degree of representation or autonomy for minorities. Category 6 also contains some countries in the early or aborted stages of democratic transition. A few states in Category 6 are traditional monarchies that mitigate their relative lack of political rights through the use of consultation with their subjects, toleration of political discussion, and acceptance of petitions from the ruled.

7 Rating. This includes places where political rights are absent or virtually nonexistent due to the extremely oppressive nature of the regime or extreme oppression in combination with civil war. A country or territory may also join this category when extreme violence and warlordism dominate the people in the absence of an authoritative, functioning central government.

Civil Liberties

1 Rating. This includes countries and territories that generally have the highest levels of freedoms and opportunities for the individual. Places in this category may still have problems in civil liberties, but they lose partial credit in only a limited number of areas.

2 Rating. Places in this category, while not as free as those in 1, are still relatively high on the scale. These countries have deficiencies in several aspects of civil liberties, but still receive most available credit.

3, 4, and 5 Ratings. Places in these categories range from ones that receive at least partial credit on virtually all checklist questions to those that have a mixture of good civil liberties scores in some areas and zero or partial credit in others. As one moves down the scale below category 2, the level of oppression increases, especially in the areas of censorship, political terror and the prevention of free association. There are also many cases in which groups opposed to the state carry out political terror that undermines other freedoms. That means that a poor rating for a country is not necessarily a comment on the intentions of the government. The rating may simply reflect the real restrictions on liberty which can be caused by non-governmental terror.

6 Rating. Typically, at category 6 in civil liberties, countries and territories have few partial rights. For example, a country might have some religious freedom, some personal social freedoms, some

highly restricted private business activity, and relatively free private discussion. In general, people in these states and territories experience severely restricted expression and association. There are almost always political prisoners and other manifestations of political terror.

7 Rating. At category 7, countries and territories have virtually no freedom. An overwhelming and justified fear of repression characterizes the society.

C. Democratic Freedoms Disaggregated: Elaboration of Freedom House's Rating Scheme in its Nations in Transit 1998

In its *Nations in Transit 1998*, Freedom House measures progress towards democratic freedoms by assessing a series of questions in six categories: (1) political process; (2) civil society; (3) independent media; (4) governance and public administration; (5) rule of law; and (6) corruption. Progress towards each category is rated on a seven-category scale, 1 representing the most advanced and 7 the least advanced.

Political process

- (1) When did national legislative elections occur? Were they free and fair? How were they judged by domestic and international election monitoring organizations? Who composes the government?
- (2) When did presidential elections occur? Were they free and fair?
- (3) Is the electoral system multiparty-based? Are there at least two viable political parties functioning at all levels of government?
- (4) How many parties have been legalized? Are any particular parties illegal?
- (5) What proportion of the population belongs to political parties?
- (6) What has been the trend of voter turnout at the municipal, provincial and national levels in recent years?

Civil Society

- (1) How many nongovernmental organizations have come into existence since 1988? How many charitable/nonprofit organizations? How many were there last year? Are they financially viable?
- (2) What forms of interest group participation in politics are legal? Which interest groups are active politically?
- (3) Are there free trade unions? How many workers belong to these unions? Is the number of workers belonging to trade unions growing or decreasing?
- (4) What is the numerical/proportional membership of farmers' groups, small business associations, etc?

Independent Media

- (1) Are there legal protections for press freedoms?
- (2) Are there legal penalties for libeling officials? Are there legal penalties for "irresponsible" journalism? Have these laws been enforced to harass journalists?
- (3) What proportion of the media is privatized? What are the major private newspapers, television stations, and radio stations?
- (4) Are the private media financially viable?

- (5) Are the media editorially independent? Are the media's news gathering functions affected by interference from government or private owners?
- (6) Is the distribution system for newspapers privately or governmentally controlled?
- (7) What proportion of the population is connected to the Internet? Are there any restrictions on Internet access to private citizens?
- (8) What has been the trend in press freedom as measured by Freedom House's *Survey of Press Freedom*?

Governance and Public Administration

- (1) Is the legislature the effective rule-making institution?
- (2) Is substantial power decentralized to subnational levels of government? What specific authority do subnational levels have?
- (3) Are subnational officials chosen in free and fair elections?
- (4) Do the executive and legislative bodies operate openly and with transparency? Is draft legislation easily accessible to the media and the public?
- (5) Do municipal governments have sufficient revenues to carry out their duties? Do municipal governments have control of their own local budgets? Do they raise revenues autonomously or from the central state budget?
- (6) Do the elected local leaders and local civil servants know how to manage municipal governments effectively?
- (7) When did the constitutional/legislative changes on local power come into effect? Has there been a reform of the civil service code/system? Are local civil servants employees of the local or central government?

Rule of Law

- (1) Is there a post-Communist constitution? How does the judicial system interpret and enforce the constitution? Are there specific examples of judicial enforcement of the constitution in the last year?
- (2) Does the constitutional framework provide for human rights? Do the human rights include business and property rights?
- (3) Has there been basic reform of the criminal code/criminal law? Who authorizes searches and issues warrants? Are suspects and prisoners beaten or abused? Are there excessive delays in the criminal justice system?
- (4) Do most judges rule fairly and impartially? Do many remain from the Communist era?
- (5) Are the courts free of political control and influence? Are the courts linked directly to the Ministry of Justice or any other executive body?
- (6) What proportion of lawyers is in private practice? How does this compare with the previous year?
- (7) Does the state provide public defenders?
- (8) Are there effective antibias/discrimination laws, including protection of ethnic minorities?

Corruption

- (1) What is the magnitude of official corruption in the civil service? Must an average citizen pay a bribe to a bureaucrat in order to receive a service? What services are subject to bribe requests--for example, university entrance, hospital admission, telephone installation, obtaining a license to

operate a business, applying for a passport or other official documents? What is the average salary of civil servants at various levels?

(2) Do top policy makers (the president, ministers, vice-ministers, top court justices, and heads of agencies and commissions) have direct ties to businesses? How strong are such connections and what kinds of businesses are these?

(3) Do laws requiring financial disclosure and disallowing conflict of interest exist? Have publicized anticorruption cases been pursued? To what conclusion?

(4) What major anticorruption initiatives have been implemented? How often are anticorruption laws and decrees adopted?

(5) How do major corruption-ranking organizations like Transparency International rate this country?

APPENDIX II: CROSS-BORDER SPILLOVERS

A. Economic Repercussions from the Kosovo Crisis

Tables 1-3 and Figures 1-7 provide some very preliminary insights into the economic spillovers to South East Europe in 1999 from the Kosovo conflict. South East Europe (SEE) consists of nine countries: Albania; Bosnia-Herzegovina; Bulgaria; Croatia; Hungary; Macedonia; Romania; Slovenia; and Yugoslavia. The Front Line States (FLS) consists of the SEE countries less Yugoslavia.

Table 1 and Figures 1-3 compare relative sizes, of population and of GDP, of the countries of SEE and of the EU for an intuitive feel of possible relative impacts from a worn-torn Yugoslavia. GDP estimates based on purchasing power parities are not available for Yugoslavia and Bosnia-Herzegovina. Hence, these economic comparisons are based on the less accurate GDP estimates calculated from official exchange rates.

Several salient observations emerge. First, the Yugoslavia economy is relatively small. It is only eight percent of the SEE economy; smaller than five other SEE countries including two from the former Yugoslavia, Croatia and Slovenia. (It is much larger in population terms; sixteen percent of the SEE region's population and second only to Romania).

Second, Albania, Macedonia, and Bosnia-Herzegovina are much smaller still, and on this score look quite vulnerable. Albania's economy is less than two percent of the SEE economy; the economies of Macedonia and Bosnia-Herzegovina are only slightly larger. To the extent that these countries are integrated with or dependent on Yugoslavia in particular, they are certainly vulnerable to significant spillovers.

Third, it is striking how small the SEE region is relative to the EU, particularly in economic terms. The population of SEE is eighteen percent of the population of the EU. The SEE economy is dwarfed by the EU: SEE GDP is less than two percent of the economic size of the EU. It is not surprising that access to the EU is often viewed as the "prize." To the extent that this conflict has impeded that access, such as in the case of Bulgaria and Macedonia in particular, the economic repercussions can be substantial.

Table 2 and Figures 4 and 5 provide some rough estimates of the economic links of the region. Some of these are very preliminary numbers and represent "guesstimates" at best, particularly some of the data of exports through Yugoslavia.

The first conclusion that emerges here is that the economic links within SEE are relatively weak. The region is not very closely economically integrated. In fact, exports from the Front Line States to the EU far surpass intra-regional exports. Almost sixty percent of FLS exports in 1998 went to the EU. Less than twenty percent stayed within the SEE region.

All the FLS export a large proportion to the EU. Macedonia's exports to the EU as a percent of total exports were the lowest of the FLS in 1998: forty-five percent. The percentage of exports to within the SEE region is much more varied among the FLS. Less than ten percent of exports

from Bulgaria, Romania, Albania, and Hungary went to the SEE region in 1998. In contrast, almost one-half of Bosnia-Herzegovina's 1998 exports stayed within the SEE region, and roughly one-third of exports from Macedonia and Croatia.

Firms that exported to Yugoslavia in 1998 or had goods transit through Yugoslavia to another destination are, of course, very vulnerable in the current context. These sources of income for now are greatly diminished. For most countries of the SEE region, however, exports to and through Yugoslavia were likely minimal in 1998; perhaps five percent of total exports or less in the case of Romania, Albania, Croatia, Slovenia, and Hungary.

Macedonia and Bulgaria, by far, are bearing the brunt of the costs from trade disruption due to the war. Such costs are much smaller for Bosnia-Herzegovina, though still likely not insignificant there as well. In particular, roughly seventy percent of Macedonia's exports went to or through Yugoslavia in 1998. For Bulgaria, it may have been slightly more than one-half of all exports. While Bulgaria exported only 2.5 percent of its exports in 1998 to Yugoslavia, roughly fifty percent of its exports went through Yugoslavia to their final destination: Western Europe.

How much this trade disruption affects the domestic economy is predicated in part on how large the export sector is relative to the domestic economy. If a large proportion of exports is disrupted and yet the export sector is very small, then the proportion of GDP exposed to the conflict may be relatively small. "GDP exposure" to Yugoslavia, in other words, is the percentage of exports that go to or through Yugoslavia multiplied by the size of the export sector as a percent of GDP.

Both economies of Bulgaria and Macedonia are greatly exposed to Yugoslavia by this score. Bulgaria's export sector as a percent of GDP is the largest of all the FLS (sixty-one percent). With such a high proportion of exports dependent on Yugoslavia (seventy percent in 1998), this means that roughly one-third of Bulgaria's economy has been dependent on Yugoslavia. For Bulgaria, most of this has been transit trade that will presumably get to its destination through alternate routes (most likely through Romania). So, this is not to say that one-third of Bulgaria's economy will come to a halt for much of 1999. Rather, some exports will be lost, while in most cases, the costs of transport will increase, and these costs will filter through the economy in various ways.

For most of the FLS, GDP exposure to the EU is much higher than GDP exposure to/through Yugoslavia or to SEE. This is particularly true for Slovenia and Hungary, and to a lesser extent, Romania. A forecasted slowdown in economic growth in 1999 in Western Europe, in other words, will have much greater adverse economic repercussions in these countries than war in the SEE region.

Finally, it is striking how autarchic Albania remains. Albania's export sector is only twelve percent of GDP. This of course makes the economy relatively more insulated from "external shocks" than is the case in other more outward-oriented economies.

Table 3 and Figures 6 and 7 attempt to measure, in very broad brush, the scope of the macroeconomic impact in 1999 on the FLS from the Kosovo conflict. Most of the estimates of

the macroeconomic imbalances (fiscal and current account deficits) and of GDP growth for 1999 made prior to the escalation of war in Kosovo (i.e., pre-NATO airstrikes) are drawn from the EBRD, *Transition Report Update* (April 1999). Estimates of the marginal impacts from the conflict are drawn primarily from the IMF, *The Economic Consequences of the Kosovo Crisis--An Updated Assessment* (May 25, 1999). The IMF provides two sets of estimates corresponding to two possible scenarios. We average the estimates.¹

The economic costs stem largely from four aspects of the crisis: (a) the costs borne from hosting the refugees; (b) adverse consequences to trade; (c) dampening of investor and consumer confidence; and (d) a possible slowdown in reform progress. At the macroeconomic level, these costs are typically manifesting in (a) higher fiscal deficits (in part from growing expenditures on refugees and security, and falling tax revenues from slower economic activity); (b) higher current account deficits (largely from trade disruptions in the region); and (c) slower economic growth. Less economic growth follows from a reduction in trade, fewer foreign and domestic investments (and less access to foreign capital markets), and a loss of consumer confidence, including a loss of tourism revenues particularly in Croatia and Bulgaria. Reform momentum may slow as well, due to pressures on governments' limited capacities and on political will. A slowdown of reforms feeds back adversely on macroeconomic imbalances and economic growth.

The economic costs are significant. On average, fiscal and current account deficits in the FLS may increase in 1999 by almost two percent of GDP due to Kosovo. Most of these countries had macroeconomic imbalances that were too high prior to this setback. Bulgaria and Slovenia are the exceptions. Now, perhaps only Slovenia will have a 1999 current account deficit of less than five percent of GDP and a fiscal deficit less than three percent of GDP. For the region overall, economic growth in 1999 may fall by almost three percent; from 4.1 percent to 1.4 percent.

The economic costs to Macedonia are staggering. The political costs could be significant as well. Macedonia went into the crisis with robust economic growth forecast for 1999 (of four percent), a negligible fiscal deficit, and a new government coalition seemingly intent on pushing forward on economic reforms and mitigating ethnic tensions. The economy may now contract by more than four percent in 1999. The fiscal balance may balloon to over five percent of GDP. Moreover, the current account deficit, already on a much-too-high trajectory (of over eight percent of GDP) may now double to sixteen percent of GDP.

Albania is very vulnerable too, though the repercussions will largely surface by exacerbating already high current account and fiscal deficits. Both the current account and fiscal deficits may increase between three to four percent of GDP. This would put the current account deficit in 1999 at roughly eleven percent of GDP and the fiscal deficit at seventeen percent of GDP. Surprisingly (at least at first look), economic growth in Albania is forecast to be largely unaffected on balance, and to remain robust (i.e., five percent). This is likely due in part to Albania's autarchic nature; its export sector is very small. Moreover, what little it does trade, the proportion that is exposed to Yugoslavia is insignificant. In addition, there may be offsetting influences on economic activity in the domestic economy from such a large foreign and refugee

¹ At least two important costs are not addressed: the costs of the war to Yugoslavia itself and the costs of reconstruction in the region.

presence: disruptions to production in northern Albania may be offset some by increases in demand for goods and services.

Other FLS affected significantly include Bosnia-Herzegovina, Croatia, and Bulgaria. Economic growth in 1999 in Bosnia-Herzegovina is forecast to remain high (at 9.5 percent), though much below EBRD's earlier projection of sixteen percent (and much below the eighteen percent growth in 1998). In fact, Bosnia-Herzegovina's current account deficit may actually decrease by a percentage point relative to GDP due to the slowdown in growth and, with it, imports. This is in the context, however, of a current account deficit that remains much too high (twenty-one percent of GDP). The fiscal deficit is forecast to deteriorate by almost two percentage points in Bosnia-Herzegovina because of the conflict.

Finally, the economies in both Croatia and Bulgaria will likely slowdown considerably in 1999 as well. Previously forecast modest growth will now give way to no growth in Bulgaria and economic contraction in Croatia. Tourism will be adversely affected in both countries as will privatization-related foreign direct investment. While Bulgaria exports very little to Yugoslavia directly (2.5 percent in 1998), most of its trade is with Western Europe; that is, on the other side of Yugoslavia. Significant transit costs, in other words, will be incurred.

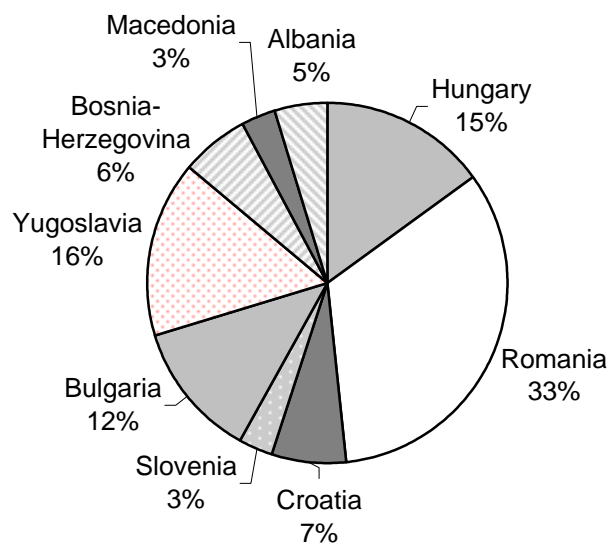
Appendix II: Table 1
1998 Population & GDP Shares In South East Europe

	Population		GDP		
	(millions)	% of SEE	mill.PPP\$	mill. US\$	% of SEE
Hungary	10.1	15.0	74,063	47,837	29.3
Romania	22.5	33.4	89,062	38,183	23.4
Croatia	4.5	6.7	22,891	20,281	12.4
Slovenia	2.0	3.0	24,710	19,652	12.0
Bulgaria	8.3	12.3	32,924	14,110	8.6
Yugoslavia	10.6	15.7	---	13,454	8.2
Bosnia-Herzegovina	4.2	6.2	---	4,082	2.5
Macedonia	2.0	3.0	6,551	3,426	2.1
Albania	3.2	4.7	7,500	2,447	1.5
South East Europe	67.5	100.0	---	163,472	100.0

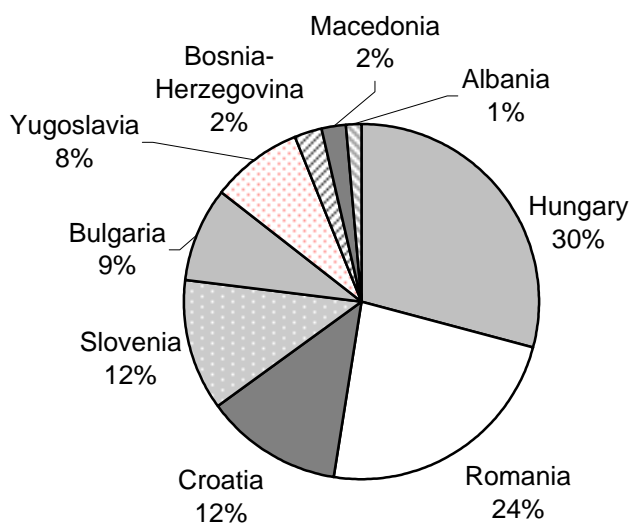
GDP is measured in US\$ converting through official exchange rates and through purchasing power parity (PPP) figures. South East Europe (SEE) consists of 9 countries: Albania; Bosnia-Herzegovina; Bulgaria; Croatia; Hungary; Macedonia; Romania; Slovenia; and Yugoslavia. The population of S.E. Europe is 18% of the EU's population; SEE GDP is 1.9% of the EU's GDP.

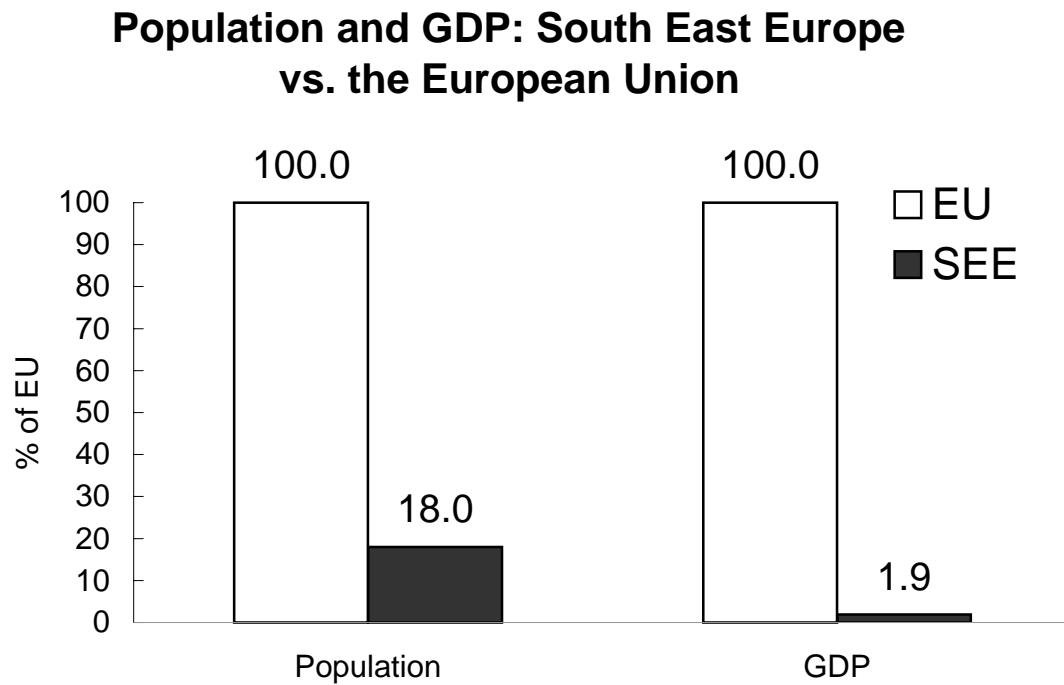
EBRD, Transition Report Update (May 1999); World Bank, Atlas (March 1999).

Share of Total Regional Population



Share of Total Regional GDP





Note: SEE consists of Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Hungary, Macedonia, Romania, Slovenia, and Yugoslavia.

EBRD, *Transition Report Update* (April 1999); World Bank, *World Bank Atlas* (March 1999)..

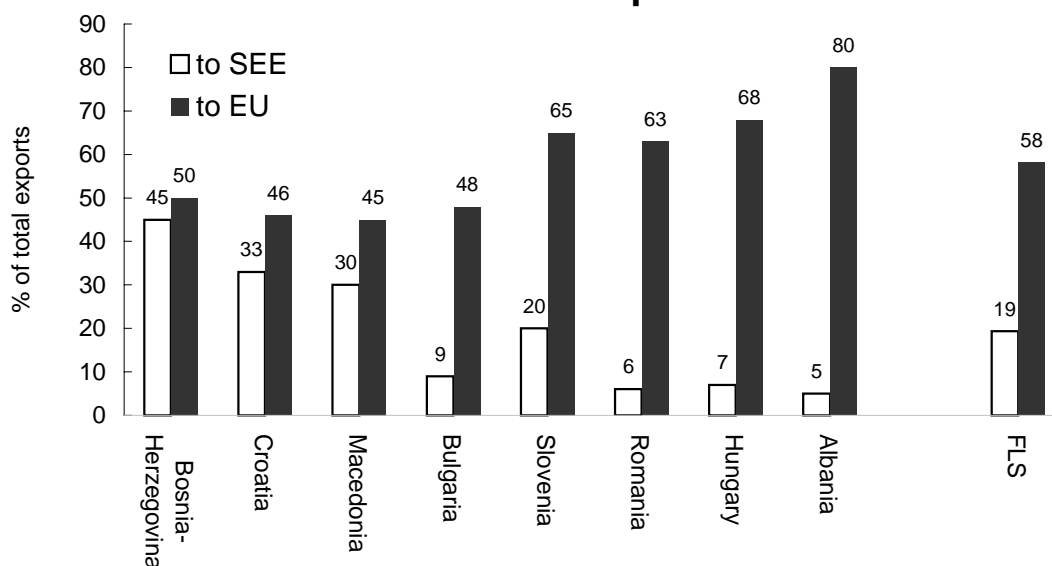
Appendix II: Table 2
Export and GDP Exposure to Conflict in South East Europe
(percent)

		1998 Exports			
	South East	European	Yugoslavia		
	Europe	Union	to	through	to & thru
Macedonia	30	45	15	55	70
Bulgaria	9	48	2.5	50	52.5
Bosnia-H	45	50	5	4	9
Romania	6	63	1.7	3	4.7
Albania	5	80	1	3	4
Croatia	33	46	1	2	3
Slovenia	20	65	1	2	3
Hungary	7	68	1	1	2
FLS	19.4	58.1	3.5	15.0	18.5

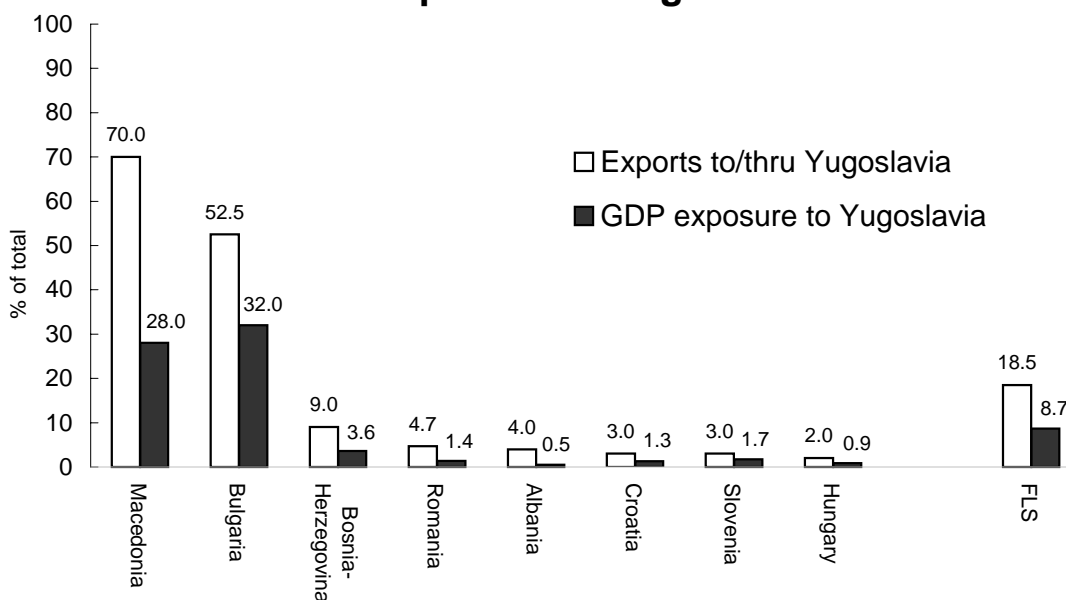
	Exports as % of GDP	(1) to S.E.Eur	GDP Exposure (2) to EU	(3) to Yugoslav	(4) to/thru Yugoslav
Bulgaria	61	5.5	29.3	1.5	32.0
Macedonia	40	12.0	18.0	6.0	28.0
Bosnia-H	40	18.0	20.0	2.0	3.6
Slovenia	57	11.4	37.1	0.6	1.7
Romania	30	1.8	18.9	0.5	1.4
Croatia	42	13.9	19.3	0.4	1.3
Hungary	45	3.2	30.6	0.5	0.9
Albania	12	0.6	9.6	0.1	0.5
FLS	40.9	8.3	22.8	1.4	8.7

Primary sources: IMF, Direction of Trade (May 1999), EIU country reports; & World Bank, WDI (1999)
The Front Line States (FLS) consist of the 7 countries which border Yugoslavia plus Slovenia.
South East Europe consists of the FLS plus Yugoslavia. GDP exposure is the proportion of GDP
exposed through exports to economic events beyond a country's borders; i.e., % of exports to
Yugoslavia (e.g.) times the % of exports to GDP.

1998 Exports to South East Europe and the European Union



1998 Exports and GDP Exposure to Yugoslavia



Note: South East Europe (SEE) consists of Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Hungary, Macedonia, Romania, Slovenia, and Yugoslavia. The Front Line States (FLS) consist of SEE less Yugoslavia. GDP exposure is the proportion of GDP exposed to the Yugoslav economy through exports, i.e., the % of exports to/through Yugoslavia multiplied by exports as a % of GDP.

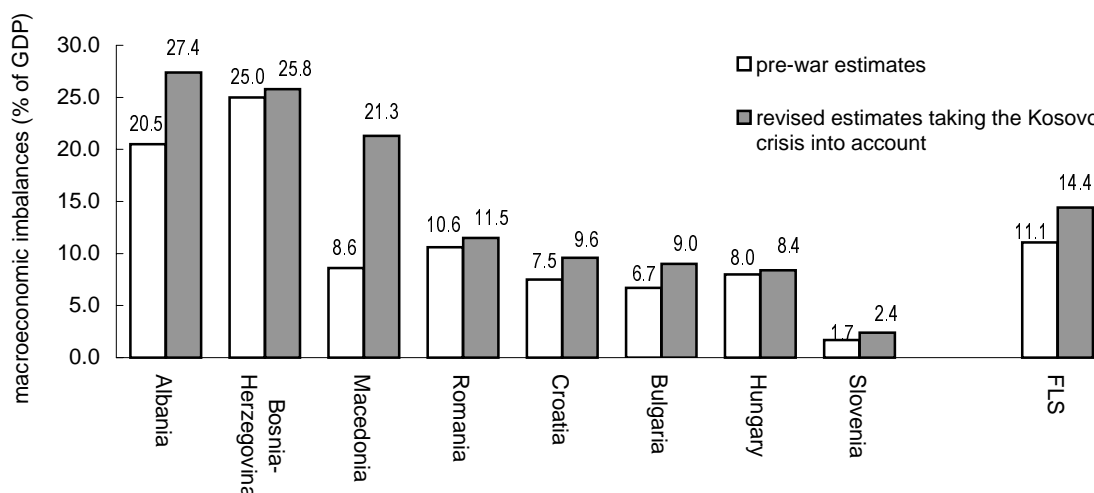
IMF, *Direction of Trade Statistics* (May 1999); EIU country reports; World Bank, *World Development Indicators 1999* (March 1999).

Appendix II: Table 3
Economic Consequences of Kosovo on the Front Line States
(Pre (a) and post (b) war estimates of 1999 performance)

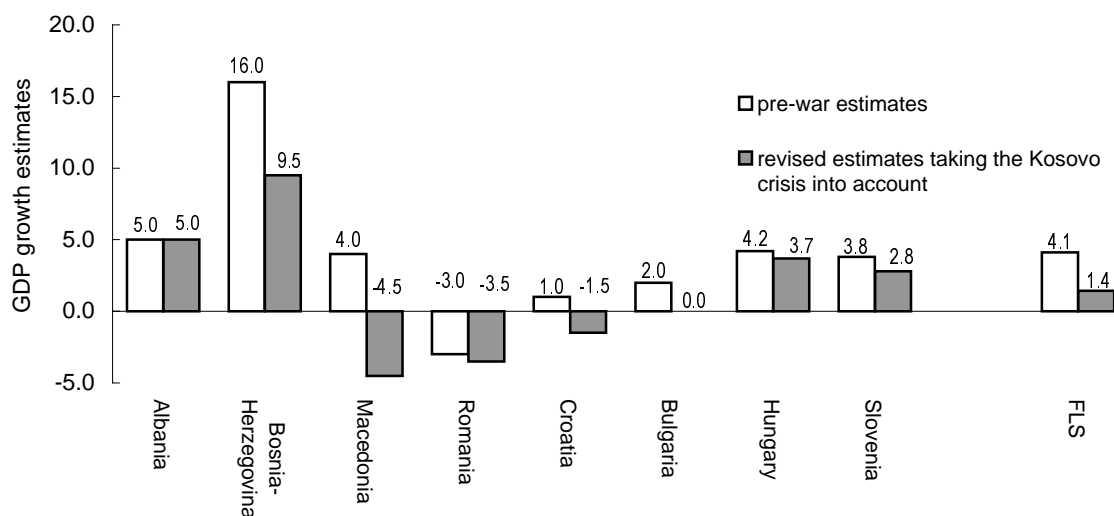
	Macro-economic imbalances (% of GDP)						Economic Growth		
	1. Current account			2. Fiscal			(a)	(b)	Difference
	(a)	(b)	Difference	(a)	(b)	Difference	(a)	(b)	Difference
Macedonia	-8.4	-16.0	-7.6	-0.2	-5.3	-5.1	4.0	-4.5	-8.5
Bosnia-H	-22.0	-21.0	1.0	-3.0	-4.8	-1.8	16.0	9.5	-6.5
				*					
Croatia	-5.7	-6.7	-1.0	-1.8	-2.9	-1.1	1.0	-1.5	-2.5
Bulgaria	-3.9	-5.2	-1.3	-2.8	-3.8	-1.0	2.0	0.0	-2.0
				*					
Slovenia	-0.7	-1.2	-0.5	-1.0	-1.2	-0.2	3.8	2.8	-1.0
		*		*	*			*	
Romania	-6.9	-7.6	-0.7	-3.7	-3.9	-0.2	-3.0	-3.5	-0.5
Hungary	-4.1	-4.0	0.1	-3.9	-4.4	-0.5	4.2	3.7	-0.5
		*							
Albania	-7.5	-10.8	-3.3	-13.0	-16.6	-3.6	5.0	5.0	0.0
FLS (i)	-7.4	-9.1	-1.7	-3.7	-5.4	-1.7	4.1	1.4	-2.7
(ii)	-6.3	-7.3	-1.0	-3.7	-4.6	-0.9	1.2	-0.3	-1.5

Pre-war estimates are primarily from EBRD, Transition Report Update (May 1999); post-war estimates are drawn primarily from IMF, The Economic Consequences of the Kosovo Crisis--An Updated Assessment (May 25, 1999). Unweighted (i) and population-weighted (ii) averages are provided for the Front Line States (FLS). These estimates, particularly those with a "*" below, are very preliminary!

Macroeconomic Imbalances in South East Europe: Pre- and Post-war Estimates for 1999



Economic Growth in South East Europe: Pre- and Post-war Estimates for 1999



Note: South East Europe (SEE) consists of Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Hungary, Macedonia, Romania, Slovenia, and Yugoslavia. The Front Line States (FLS) consist of SEE less Yugoslavia. Macroeconomic imbalances are the sum of the current account deficit (as % of GDP) and fiscal deficit (as % of GDP). Pre-war estimates are primarily from EBRD, *Transition Report Update* (April 1999); post-war estimates are drawn primarily from IMF, *The Economic Consequences of the Kosovo Crisis--An Updated Assessment* (May 25, 1999).

B. The Global Financial Crisis and the Transition Countries

Tables 4-8 shed light on the economic spillovers to the transition countries from the global financial crisis that began in July 1997 in Thailand and spread with some force to the transition region in August 1998 with the currency devaluation and debt default in Russia. These data are drawn (and in some cases updated) from a more extensive analysis which the reader is referred to for further elaboration.²

We look at two types of spillover effects. The first, and the most significant, is the cross-country spillovers from economic links to a Russia in crisis. The second refers to the effects from global trade and financial markets.

In sum, the data suggest the following conclusions. In some important respects, Russia's high vulnerability to global market trends sets it apart from the rest. Russia, for example, has been much more exposed to highly volatile short-term capital flows than have other countries in the transition region, and even more exposed than most of the Asian countries that succumbed to financial crisis. This is evident in part in *Table 6* that shows that short-term debt relative to foreign exchange reserves has been much greater in Russia than elsewhere.

Nevertheless, there is a significant number of other transition countries that have incurred high costs from the global financial crisis due largely to sharply falling prices of commodity exports and/or close economic ties to a contracting Russian economy. *Table 4* shows economic ties to Russia through exports. *Table 5* highlights the exposure of trade in commodities. The impact has been greatest in the countries of West NIS (Belarus, Moldova, and Ukraine) and among the Central Asian Republics. For these countries in particular, the overall macroeconomic dynamics have translated into slower growing economies (or greater economic contraction), greater domestic macroeconomic imbalances (*Table 7*), and, in some instances, growing vulnerabilities to further financial contagion. Reform backsliding looks to be a spillover as well in many of these countries.

In contrast, another group of transition countries—particularly four Northern Tier CEE countries (Poland, the Czech Republic, Hungary, and Slovenia) and perhaps Bulgaria—has weathered the global financial crisis relatively well. Foreign currency reserves in these countries have been high and growing (*Table 6*). Stock markets have rebounded. Falling commodity prices have translated into cheaper imports (*Table 5*). Particularly for the four Northern Tier CEE countries, economic ties are weak with Russia and strong with Western Europe (*Table 4*). Moreover, a solid foundation of economic and political institutions among the transition leaders has helped cushion and minimize shocks from global market forces.

Table 8 is an attempt to summarize these varying impacts across the region from financial crises. Drawing from the previous data, four types of effects are assessed on a one-to-four rating scheme for each country, and given equal weight in an overall average score. Two types of effects derive from global markets: financial contagion from global financial markets; and terms of trade trends stemming from falling commodity prices. Two types of effects are spillovers from the crisis in

² USAID/ENI/PCS, *The Global Financial Crisis and the Transition Countries* (March 1999).

Russia: GDP exposure to the Russia economy through exports; and other economic links (including service incomes and financial markets).

C. Cross-Border Spillovers Combined

Table 9 and *Figure 8* provide some insight on the cumulative affect in the transition region of both the global financial crisis and the Kosovo conflict. Economic growth forecasts for 1998 and 1999 from the EBRD in the spring of 1998 are compared with actual growth figures in 1998 and revised forecasts for 1999 in light of the adverse external conditions.

The adjustments are striking. In the spring of 1998, the EBRD forecast robust economic growth in the Northern Tier CEE countries for both 1998 (4.7 percent) and 1999 (4.2 percent). It had growth accelerating in both the Southern Tier CEE and the NIS from roughly 2.5 percent in 1998 to 3.5 percent in 1999.

The more likely scenario now is much more sobering, particularly in the Southern Tier CEE and the NIS. In both subregions, economic activity contracted in 1998 and is forecast to contract even more in 1999. Even the Northern Tier CEE countries have not escaped. There, 1998 growth was relatively robust (at 3.7 percent), though one percentage point less than previously forecast. As growth slows in Western Europe in 1999 (a second round effect of the global financial crisis), growth will slow in the Northern Tier as well, to some moderate rate of perhaps 2.5 percent. Eighteen countries had lower growth in 1998 than originally forecast. All the transition countries, save Turkmenistan, are now expected to have lower growth or greater contractions in 1999 than was earlier forecast.

Appendix II: Table 4
Export and GDP Exposure to Russia
(Percent)

	Exports to Russia		1994-97 %	Exports	GDP
	1994	1997	Change	to GDP	Exposure*
Belarus	47	65	18	60	39
Moldova	51	58	7	53	31
Tajikistan	9	15	6	114	17
Kazakhstan	43	34	-9	35	12
Uzbekistan	40	31	-9	38	12
Latvia	28	21	-7	50	11
Ukraine	40	22	-18	41	9
Kyrgyzstan	30	22	-8	35	8
Lithuania	28	13	-15	55	7
Estonia	23	8	-15	77	6
Bulgaria	9	8	-1	61	5
Azerbaijan	22	23	1	19	4
Armenia	35	21	-14	20	4
Georgia	34	30	-4	12	4
Turkmenistan	5	8	3	41	3
Poland	5	8	3	26	2
Hungary	8	5	-3	45	2
Slovenia	4	4	0	57	2
Croatia	3	4	1	42	2
Czech Republic	4	3	-1	58	2
Slovakia	4	3	-1	56	2
Romania	3	3	0	30	1
Macedonia	7	3	-4	40	1
Bosnia-Herzegovina	16	2	-14	40	1
Albania	0	0	0	12	0
Yugoslavia	0	0	0	--	0
NIS	32	30	-2	43	13
NIS	32	30	-2	43	13
Baltics	26	14	-12	61	8

* GDP exposure is the proportion of GDP exposed to the Russian economy through exports; i.e., % of exports to Russia times the % of exports to GDP.

IMF, Direction of Trade (December 1998); EBRD, Transition Report (November 1998); World Bank, World Development Indicators (March 1999).

Appendix II: Table 5

Trade in Commodities with substantial price declines
(Percent of total exports (X) and imports (M) by country)

	Energy*		Metals		Textile Fibers		Totals		Net
	X	M	X	M	X	M	X	M	Exports
Group 1									
(High costs)									
Turkmenistan	52	2	0	2	27	0	79	4	75
Uzbekistan	1	0	9	5	58	0	68	5	63
Russia	21	1	34	1	0	0	55	2	53
Azerbaijan	35	0	1	6	18	0	54	6	48
Tajikistan	0	8	11	3	41	0	52	11	41
Kazakhstan	23	15	32	6	3	0	58	21	37
Kyrgyzstan	0	8	32	2	9	0	41	10	31
Group 2									
(Modest costs)									
Macedonia	0	1	21	3	0	1	21	5	16
Georgia	14	15	15	2	0	0	29	17	12
Yugoslavia	0	3	14	3	0	0	14	6	8
Group 3									
(Little effects)									
Belarus	8	1	6	9	0	0	14	10	4
Albania	2	1	7	5	0	0	9	6	3
Bosnia-Herzegov.	0	2	8	3	0	0	8	5	3
Slovakia	7	14	15	6	0	0	22	20	2
Croatia	6	3	3	5	0	0	9	8	1
Romania	1	12	15	3	0	0	16	15	1
Poland	1	7	10	4	0	0	11	11	0
Group 4									
(Modest gains)									
Latvia	22	30	9	4	1	0	32	34	-2
Bulgaria	0	19	20	4	0	1	20	24	-4
Lithuania	17	21	3	3	0	0	20	24	-4
Czech Republic	1	9	8	5	0	0	9	14	-5
Estonia	4	11	3	4	0	0	7	15	-8
Armenia	0	12	4	1	0	0	4	13	-9
Ukraine	5	49	31	2	0	0	36	51	-15
Moldova	0	33	6	2	0	0	6	35	-29

U.S. Department of Commerce International Trade Database (Jan.1999). 1997 data.

* Energy: petroleum & petroleum products, and natural gas; Metals: non-ferrous metals (e.g.copper, aluminum, zinc), iron & steel, metal ores, gold; Textile fibers: cotton & wool.

Appendix II: Table 6
Vulnerabilities to (and Impacts from) Global Financial Markets

	Short Term Debt to Reserves			1998 Reserves in months of Imports
	1997	1998		
Russia	2.51	2.21	Belarus	0.1
Tajikistan	1.23	0.96	Ukraine	0.8
Slovakia	0.69	0.86	Georgia	1.3
Ukraine	0.45	0.70	Tajikistan	1.4
Hungary	0.46	0.60	Bosnia-Herzegovina	1.6
Czech Republic	0.55	0.57	Russia	1.7
Romania	0.33	0.52	Romania	1.7
Turkmenistan	0.41	0.51	Macedonia	2.0
Uzbekistan	0.46	0.51	Estonia	2.0
Macedonia	0.51	0.46	Latvia	2.2
Croatia	0.56	0.45	Azerbaijan	2.2
Estonia	0.42	0.40	Slovakia	2.3
Kazakhstan	0.21	0.35	Kazakhstan	2.8
Lithuania	0.15	0.25	Moldova	2.8
Latvia	0.08	0.24	Kyrgyzstan	2.9
Bosnia-Herzegovina	0.25	0.23	Lithuania	3.0
Georgia	0.10	0.23	Uzbekistan	3.1
Poland	0.18	0.22	Croatia	3.3
Belarus	0.58	0.20	Armenia	3.6
Kyrgyzstan	0.19	0.19	Slovenia	3.7
Moldova	0.06	0.17	Czech Republic	4.1
Albania	0.15	0.16	Hungary	4.4
Armenia	0.10	0.16	Albania	4.5
Slovenia	0.14	0.16	Bulgaria	5.5
Bulgaria	0.33	0.15	Poland	6.8
Azerbaijan	0.01	0.02	Turkmenistan	9.4
Northern Tier CEE	0.33	0.41	Northern Tier CEE	3.6
Northern Tier CEE	0.33	0.41	Northern Tier CEE	3.6
NIS	0.53	0.52	NIS	2.7
NIS less Russia	0.35	0.36	NIS less Turkmenistn	2.1
Emerging Market				
Comparators	1.70	1.08		4.9
Asia	1.77	0.75		4.4
Latin America	1.16	1.08		5.7
South Africa	2.92	2.74		---

See notes on following page.

Table 6 notes.

Sources: IMF, International Financial Statistics (May 1999); BIS, The Maturity, Sectoral & Nationality Distribution of International Bank Lending, statistical annex (1998 & 1999); EBRD, Transition Report Update (April 1999).

1998 ST debt data refer to end-year except in the cases of June 1998 data for Uzbekistan, Kazakhstan, and Albania. Reserves to imports are measured by the EBRD in one of two primary ways: reserves in (a) months of imports and in (b) months of current account expenditures.

The comparators:

	Short Term Debt to Reserves			1998 Reserves in months of Imports
	1997	1998		
Asia:				
Indonesia	2.13	1.04	Indonesia	5.2
South Korea	2.92	0.57	South Korea	5.1
Malaysia	0.70	0.36	Malaysia	2.7
Philippines	1.64	0.94	Philippines	2.4
Thailand	1.48	0.82	Thailand	6.7
Latin America:				
Brazil	0.96	0.96	Brazil	6.6
Argentina	1.55	1.36	Argentina	7.8
Mexico	0.96	0.92	Mexico	2.6
South Africa	2.92	2.74	South Africa	--

Appendix II: Table 7
Macroeconomic Imbalances & Debt Service Payments

	1998 Balances (% of GDP)		Sum of Balances	1998 Debt service (% of exports)
	1. Fiscal	2. Current Acct		
Group 1:*				
Turkmenistan	-4.0	-52.7	-56.7	---
Azerbaijan	-4.1	-31.1	-35.2	7.0
Armenia	-5.2	-27.8	-33.0	12.3
Bosnia-Herzegovina	-3.0	-29.0	-32.0	9.0
Moldova	-7.5	-19.7	-27.2	17.4
Kyrgyzstan	-9.8	-15.0	-24.8	8.0
Lithuania	-6.0	-13.5	-19.5	12.1
Albania	-10.7	-8.1	-18.8	6.2
Georgia	-4.4	-12.2	-16.6	21.8
Slovakia	-5.6	-10.9	-16.5	11.6
Kazakhstan	-8.0	-6.5	-14.5	'---
Romania	-5.5	-7.9	-13.4	20.2
Tajikistan	-3.2	-7.3	-10.5	11.4
Group 2:				
Latvia	0.1	-11.2	-11.1	14.6
Macedonia	-1.7	-9.2	-10.9	9.2
Hungary	-4.6	-4.7	-9.3	43.6
Estonia	-0.3	-8.6	-8.9	3.2
Belarus	-1.0	-6.8	-7.8	2.2
Croatia	0.5	-7.1	-6.6	11.2
Uzbekistan	-3.8	-3.7	-7.5	14.7
Russia	-3.6	0.7	-2.9	10.5
Ukraine	-2.5	-1.4	-3.9	20.0
Group 3:				
Poland	-3.0	-4.5	-7.5	5.9
Czech Republic	-2.7	-1.9	-4.6	15.0
Slovenia	-1.4	0.0	-1.4	13.2
Bulgaria	1.0	-1.2	-0.2	15.5
Southern Tier CEE	-3.2	-10.4	-13.7	11.9
NIS	-4.8	-15.3	-20.1	17.9

* Group 1: fiscal deficit is greater than 3% of GDP and the current account deficit is greater than 5% of GDP; Group 2: fiscal deficit is greater than 3% of GDP or the current account deficit is greater than 5% of GDP or debt service is equal to or greater than 20% of exports; Group 3: fiscal deficit is equal to or less than 3% of GDP, current account deficit is equal to or less than 5% of GDP, and debt service is less than 20% of exports.. Debt service to exports are measured two primary ways: as % of exports and as % of current account revenues. Debt service data are for 1997 for Moldova, Albania, Romania, Macedonia, Hungary, Poland, and Bulgaria.

Primary source: EBRD, Transition Report Update (April 1999).

Appendix II: Table 8

Summary Assessment of the Impact from Financial Crises*

	I. Global Markets						II. Economic Links with Russia			Overall Score
	A. Financial Markets			B. Trade			A. Trade	B. Other**	A. & B.	
	Debt /Res.	Res. /M	Macro Imbal.	Ave.		A. & B. Ave.			Ave.	
Group 1: Russia	4	4	2	3.3	4	3.7	--	--	4.0	3.8
Group 2:										
Kazakhstan	2	3	4	3.0	4	3.5	3	3	3.0	3.3
Belarus	1	4	3	2.7	2	2.3	4	4	4.0	3.2
Tajikistan	3	4	4	3.7	4	3.8	3	2	2.5	3.2
Moldova	1	3	4	2.7	1	1.8	4	4	4.0	2.9
Kyrgyzstan	1	3	4	2.7	4	3.3	3	2	2.5	2.9
Uzbekistan	3	2	2	2.3	4	3.2	3	2	2.5	2.8
Ukraine	3	4	2	3.0	1	2.0	3	4	3.5	2.8
Georgia	1	4	4	3.0	3	3.0	2	3	2.5	2.8
Turkmenstn	3	1	4	2.7	4	3.3	2	2	2.0	2.7
Azerbaijan	1	3	4	2.7	4	3.3	2	2	2.0	2.7
Group 3:										
Latvia	1	3	3	2.3	1	1.7	3	3	3.0	2.3
Armenia	1	2	4	2.3	1	1.7	2	3	2.5	2.1
Lithuania	1	2	4	2.3	1	1.7	3	2	2.5	2.1
Romania	3	4	4	3.7	2	2.8	1	1	1.0	1.9
Estonia	2	3	3	2.7	1	1.8	2	2	2.0	1.9
Macedonia	2	3	3	2.7	3	2.8	1	1	1.0	1.9
Slovakia	3	3	4	3.3	2	2.7	1	1	1.0	1.8
Bosnia-H.	1	4	4	3.0	2	2.5	1	1	1.0	1.8
Croatia	2	2	3	2.3	2	2.2	1	1	1.0	1.6
Albania	1	1	4	2.0	2	2.0	1	1	1.0	1.5
Group 4:										
Bulgaria	1	1	1	1.0	1	1.0	2	1	1.5	1.3
Hungary	3	1	3	2.3	1	1.7	1	1	1.0	1.3
Poland	1	1	1	1.0	2	1.5	1	1	1.0	1.3
Czech Rep.	3	1	1	1.7	1	1.3	1	1	1.0	1.2
Slovenia	1	2	1	1.3	1	1.2	1	1	1.0	1.1
Yugoslavia	--	--	--	--	3	--	1	1	1	--

* Rating is from 1-4; 4 signifies "highly vulnerable"; 3: "high to moderate vulnerability"; 2: "moderate vulnerability to insignificant"; and 1: "insignificant costs to modest gains". Ratings, indicators, and sources derive from previous tables. ** Other links refer to service income (incl., remittances & transport fee incomes) & financial markets (incl., bank exposure & exchange rate pressures).

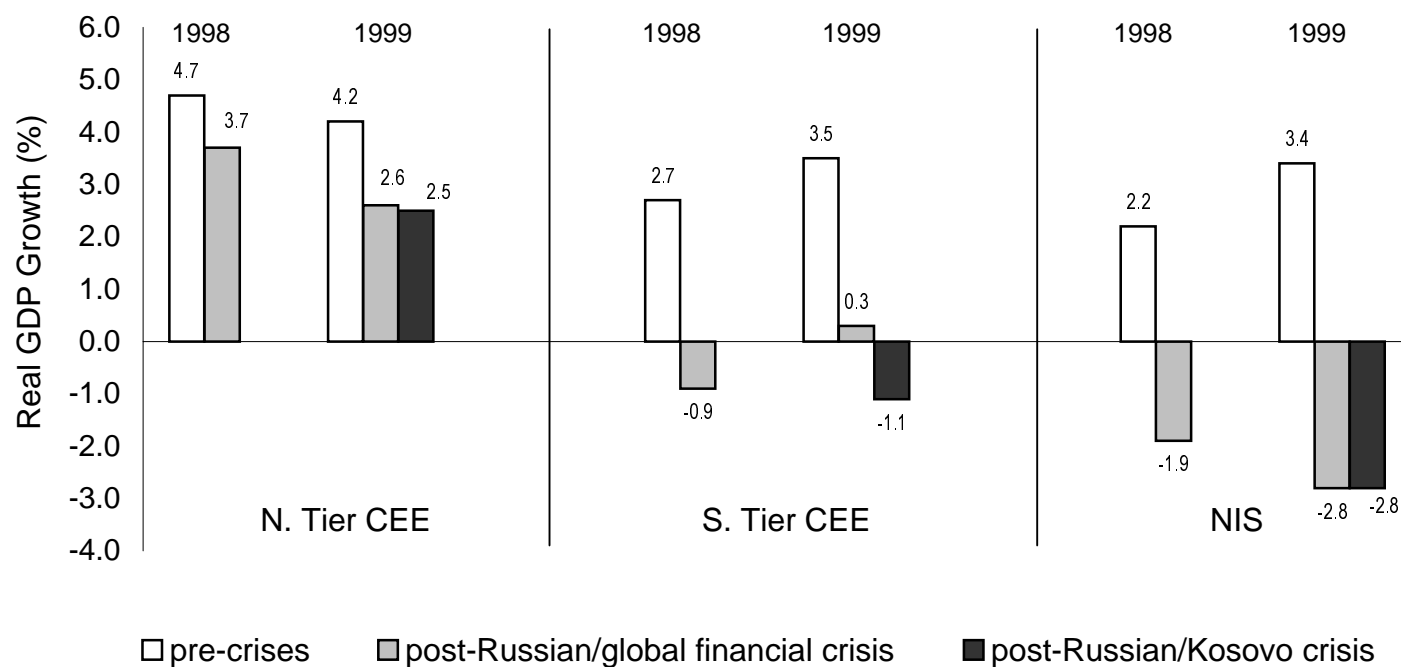
Appendix II: Table 9

Real GDP Growth projections, 1998-1999: pre- & post crises scenarios

	1998*		1999*		
	pre Russia	post Russia	pre Russia	post Russia	post Russia & Kosovo
Albania	12.0	8.0	8.0	5.0	5.0
Armenia	6.0	7.2	5.0	4.0	4.0
Azerbaijan	7.0	10.1	8.5	5.0	5.0
Belarus	2.0	8.0	4.0	-2.0	-2.0
Bulgaria	2.5	2.5	3.5	2.0	0.0
Croatia	5.5	2.5	4.5	1.0	-1.5
Czech R	2.0	-2.7	2.0	0.0	0.0
Estonia	5.5	4.0	4.9	3.0	3.0
Macedonia	5.0	3.0	4.0	4.0	-4.5
Georgia	10.0	2.9	8.0	2.0	2.0
Hungary	4.5	5.0	4.4	4.2	3.7
Kazakhstan	2.7	-2.5	3.0	-3.0	-3.0
Kyrgyzstan	5.9	1.8	4.5	2.0	2.0
Latvia	6.0	4.0	4.6	2.6	2.6
Lithuania	5.5	4.0	4.0	2.5	2.5
Moldova	1.0	-8.6	2.0	-5.0	-5.0
Poland	5.5	4.8	5.0	3.0	3.0
Romania	-2.0	-7.3	1.0	-3.0	-3.5
Russia	1.5	-4.6	3.0	-5.0	-5.0
Slovakia	3.5	4.4	1.5	1.0	1.0
Slovenia	3.8	4.0	4.5	3.8	2.8
Tajikistan	4.4	4.0	4.5	3.0	3.0
Turkmenistan	12.0	4.2	13.0	20.0	20.0
Ukraine	1.0	-1.7	2.5	-3.5	-3.5
Uzbekistan	2.0	2.0	3.0	1.0	1.0
Bosnia-Herzegovina	30.0	18.0	20.0	16.0	9.5
Stier CEE	2.7	-0.9	3.5	0.3	-1.1
NIS	2.2	-1.9	3.4	-2.8	-2.8
FLS	3.1	0.0	3.7	1.2	-0.3

* 1998 forecasts: (a) pre-Russian crisis (from EBRD's Transition Report Update, 4/98); and (b) post-Russian crisis (from EBRD's TR Update, 4/99); 1999 forecasts: (a) pre-Russian crisis (from EBRD, 4/98); (b) post-Russian crisis (EBRD, 4/99); & (c) post-Kosovo war (IMF estimates with EBRD, 4/99)

Real GDP Growth Projections, 1998-1999: Pre- and Post-Crises Scenarios



Note: 1998 forecasts: (a) pre-Russian crisis, from EBRD, *Transition Report Update* (April 1998); (b) post-Russian crisis, from EBRD, *Transition Report Update* (April 1999). 1999 forecasts: (a) pre-Russian crisis, from EBRD (April 1998); (b) post-Russian crisis, from EBRD (April 1999); and post-Kosovo war, from IMF estimates with EBRD (April 1999).